Chapter 2

The economic dimensions of globalization

While the globalization process is a complex and multidimensional phenomenon, some of its most visible and influential aspects are economic in nature. This chapter contains an analysis, from a global standpoint, of major trends in trade, investment, finance, macroeconomic regimes and international labour mobility. This analysis covers a long period in history, from the last quarter of the nineteenth century to the present, and is structured according to the successive phases of globalization identified in the preceding chapter.

The first section focuses on the development of trade and investment flows among the principal regions of the world, with emphasis on the variable relationship between the expansion of trade and economic growth, the emergence of integrated production systems underpinning the operations of transnational corporations, the primary challenges faced by developing countries as a result of these global trends and the creation of an international institutional framework in the area of trade. The second section contains an analysis of the most important changes that have taken place in international finance and macroeconomic regimes. After reviewing major historical developments in this area, the study focuses on the volatility and contagion which have characterized capital flows in the third phase of globalization, and finally analyses the magnitude and composition of capital flows to developing countries.

The last section presents an overview of the phenomenon of international labour migration. It includes a comparison of the relative magnitude of migratory flows and the regulatory environment in which they took place during the different phases of globalization, as well as the various global patterns of origin and destination of migrants.

I. International trade and investment

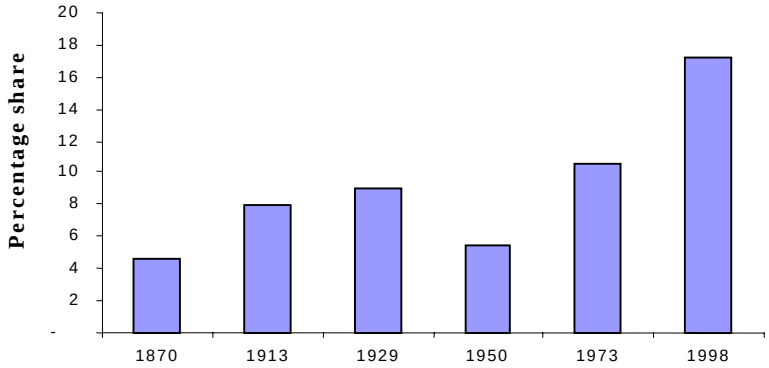
1. International trade and economic growth: a variable historical relationship

Throughout the nineteenth century, world trade expanded rapidly, outpacing world GDP, which also grew briskly (see figure 2.1). This expansion can be traced to a number of factors, including the first industrial revolutions and the consequent drop in transport costs, the "*pax Britannica*" imposed at the end of the Napoleonic wars and the replacement of the principles of mercantilist regulation with those of free enterprise.

Figure 2.1
TRADE AND GLOBAL OUTPUT, 1870-1998

A. Growth in world output and exports of goods

B. Ratio of exports to world GDP



Source: Angus Maddison, *The World Economy. A Millennial Perspective*, Paris, Organisation for Economic Co-operation and Development (OECD), 2001.

This period and, in particular, what was referred to in the preceding chapter as the first phase of globalization (1870-1913) was marked by considerable international mobility of capital and labour and by the spread of the gold standard, beginning in 1870, as a system of international payments and macroeconomic regulation. However, contrary to what is widely believed, the period also witnessed the emergence of new forms of State regulation in relation to the economy (currency and financial system) and social well-being (principles of worker protection and social security) and, especially, the maintenance of numerous restrictions on the free trade of goods.

In fact, except in the European powers committed to free trade (England and the Netherlands, in particular), in colonies whose economic relations with their respective ruling powers were governed by this system and in some independent powers on which similar requirements were imposed (Japan, which did not regain tariff autonomy until 1911, China and the Ottoman Empire, among others), and apart from a more widespread trend towards this form of trade in the 1860s and 1870s,[1] trade protectionism was the norm or, more specifically, the rule prevailing in all nations that maintained their tariff autonomy. Protectionism was the predominant practice in continental Europe, the United States, the self-governing territories of the British Empire that kept their autonomy (Canada and Australia) and many Latin American countries.[2] Bairoch (1993) has rightly argued that, in this period, it was economic growth that fuelled the expansion of international trade, and not vice versa. Accordingly, the idea that free trade was the primary engine of world economic growth between the mid-nineteenth century and the First World War is one of the great myths of history.

Table 2.1
GLOBAL EXPORTS, BY ORIGIN
(Percentage share at current exchange rate, 56 countries)

	1870	1913	1929	1950	1950	1973	1990	1998
				Excluding Africa	Including Africa			
Western Europe	65.7	56.3	47.4	40.8	38.6	50.3	51.9	47.4
United Kingdom	21.7	15.0	12.1	12.7	12.0	5.8	6.1	5.6
Continent	44.1	41.3	35.3	28.1	26.6	44.6	45.8	41.7
Central and Eastern Europe	5.8	6.0	6.6	8.3	7.8	9.2	5.4	4.9
United States and Canada	10.3	16.4	21.4	26.7	25.3	19.1	17.0	18.6
Other industrialized countries	2.8	4.7	6.2	6.0	5.7	9.6	11.0	9.5
Latin America and the Caribbean								
Asian developing countries	10.6	9.3	10.5	8.4	7.9	5.1	9.5	13.1
Africa					5.4	2.9	1.7	1.5
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Calculated by ECLAC on the basis of Angus Maddison, *The World Economy. A Millennial Perspective*, Paris, Organisation for Economic Co-operation and Development (OECD), 2001.

The rapid growth of international trade was interrupted between the two world wars. Contributing to this break in the trend were global political instability, the deceleration of economic growth in the developed countries, the inability to restore the gold standard and, in particular, the frequent use of protectionist measures (exchange and import controls) and the widespread breakdown of the multilateral payments system during the depression of the 1930s. This explains the importance attached, after the Second World War, to standard-setting and the establishment of international organizations, which evidently were shaped by the unequal power structure of the

[1] The most notable exception was the United States, which adopted highly protectionist principles after the victory of the northern states in the civil war.

[2] The Latin American countries concerned include Brazil, Chile, Colombia and Mexico (Bairoch, 1993, part I; Maddison, 1989, chap. 4; Cárdenas, Ocampo and Thorp, 2000a).

players that took part in the process. The development of this institutional framework will be analysed later in this document.

As a reflection of the manner in which the international trading system was structured in the post-war period, the most dynamic trade flows were originally centred in the two large European trading blocs. Subsequent developments in the two blocs were dissimilar, since the European Community, now the European Union, succeeded in consolidating itself, while the Council for Mutual Economic Assistance (CMEA), consisting of the socialist countries of Central and Eastern Europe, entered a period of decline and later disappeared. Japan and the first generation of "Asian tigers" also began to increase their share of world trade shortly after the end of the war, as a result of planning systems in which the conquest of foreign markets was a central component of development strategy. All the other regions of the world experienced a decline in their share of world trade between 1950 and 1973 (see table 2.2).

The emergence of a highly dynamic trading bloc in East Asia became the most striking feature of world trade beginning in the mid-1970s. Japan lost its lead in the last decade of the twentieth century, while China emerged as the most dynamic international trade hub. Other major changes also took place in the 1990s, in particular the renewed vigour of exports from the United States.

Latin America's share of world exports fell drastically between 1950 and 1973, stabilized between 1973 and 1990 and then began to increase. Most of the increase is attributable to the upsurge in Mexican exports under the North American Free Trade Agreement. However, accelerated growth in exports from small economies, as compared to the growth of aggregate output, can be observed starting as early as the mid-1950s, while exports from large and medium-sized economies began to speed up shortly thereafter (see figure 2.2).[3] It was then that the countries of the region implemented various combinations of import substitution and export promotion measures, including a number of subregional integration arrangements, the first of which was that of Central America in the 1950s. This "mixed model", rather than import substitution alone, as is often claimed, was the arrangement most commonly adopted in the region beginning in the 1960s (Cárdenas, Ocampo and Thorp, 2000b), and, in reality, the one advocated by ECLAC since the late 1950s (ECLAC, 1998b; Bielschowsky, 1998; Rosenthal, 2001). As early as the mid-1970s, the growth of exports began to surpass that of GDP in the region as a whole. This trend intensified during the "lost decade", but more as a result of the sudden drop in GDP than of growth in exports, and, in the last decade of the twentieth century, as a consequence of their expansion.

Thus, the relationship between trade and economic growth has been variable, not only in the course of the century that preceded the Second World War, but also in more recent phases of globalization. As shown in figure 2.1, world trade and world growth accelerated simultaneously between 1950 and 1973, but the upswing in world trade was largely due to the reversal of the trend toward national isolationism observed between 1913 and 1950. The slowdown of the world economy between 1973 and 1990 was also due to the more sluggish growth of world trade, but the latter's great dynamism in the last decade of the twentieth century **was not accompanied** by further global economic expansion.

[3] Venezuela was not included in figure 2.2 because its development diverges radically from the regional average and, in fact, alters it significantly. It should be recalled that Venezuelan oil exports were very robust in terms of volume in the first decades after the Second World War, but that this trend was reversed beginning in the 1970s, partly as a result of the commitments entered into within the Organization of Petroleum Exporting Countries (OPEC).

Table 2.2
STRUCTURE OF WORLD IMPORTS, BY ORIGIN AND DESTINATION, 1985 AND 2000
(*Percentages of total world imports*)

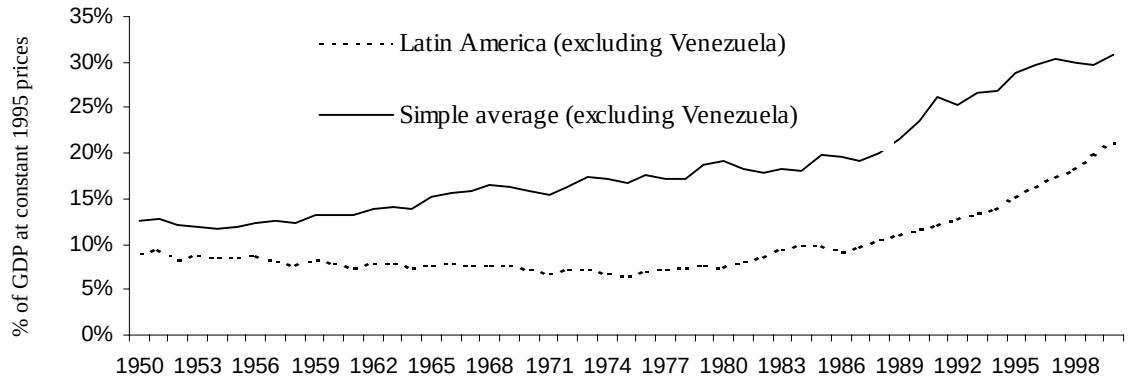
Region of destination / Region of origin	Western Europe	United States	Other industrialized	Total industrialized	Latin America and the Caribbean	Asian developing	Africa	Total developing countries	Total by origin
A. 1985									
Western Europe	30.0	5.2	1.6	*36.8*	0.8	2.5	1.2	*4.6*	41.4
United States and Canada	3.8	7.1	2.4	*13.3*	1.1	1.8	0.3	*3.2*	16.4
Other industrialized	2.3	4.8	1.0	*8.1*	0.3	2.6	0.2	*3.0*	11.1
Total industrialized	***36.1***	***17.1***	***5.0***	***58.1***	***2.2***	***6.9***	***1.7***	***10.8***	***68.9***
Latin America and the Caribbean	1.5	2.9	0.4	*4.8*	0.7	0.2	0.1	*0.9*	5.8
Asian developing countries	3.5	4.2	4.1	*11.7*	0.3	3.8	0.2	*4.3*	16.1
Africa	2.9	0.8	0.2	*3.9*	0.1	0.2	0.1	*0.4*	4.3
Total developing countries	***7.9***	***7.9***	***4.7***	***20.5***	***1.1***	***4.3***	***0.4***	***5.7***	***26.2***
Rest of world	3.3	0.2	0.3	3.8	0.1	0.8	0.3	*1.1*	4.9
Total by destination	**47.3**	**25.2**	**10.0**	**82.4**	**3.4**	**12.0**	**2.3**	**17.6**	**100.0**
B. 2000									
Western Europe	25.5	4.6	1.5	*31.7*	1.0	2.9	0.6	*4.5*	36.1
United States and Canada	3.7	6.6	1.9	*12.2*	3.2	2.4	0.1	*5.7*	17.9
Other industrialized	2.0	3.1	0.6	*5.7*	0.3	3.4	0.1	*3.7*	9.4
Total industrialized	***31.2***	***14.3***	***4.0***	***49.5***	***4.4***	***8.7***	***0.8***	***13.9***	***63.5***
Latin America and the Caribbean	0.8	3.7	0.2	*4.7*	1.0	0.3	0.0	*1.3*	6.0
Asian developing countries	4.7	5.9	3.8	*14.4*	0.5	8.2	0.2	*8.9*	23.3
Africa	1.1	0.4	0.1	*1.7*	0.1	0.4	0.1	*0.5*	2.2
Total developing countries	***6.6***	***10.0***	***4.1***	***20.7***	***1.6***	***8.8***	***0.3***	***10.7***	***31.4***
Rest of world	3.7	0.5	0.2	4.4	0.1	0.5	0.1	*0.7*	5.1
Total by destination	**41.6**	**24.8**	**8.3**	**74.7**	**6.1**	**18.0**	**1.2**	**25.3**	**100.0**

Source: ECLAC, TradeCAN 2002, on the basis of the International Commodity Trade Data Base (COMTRADE) data.

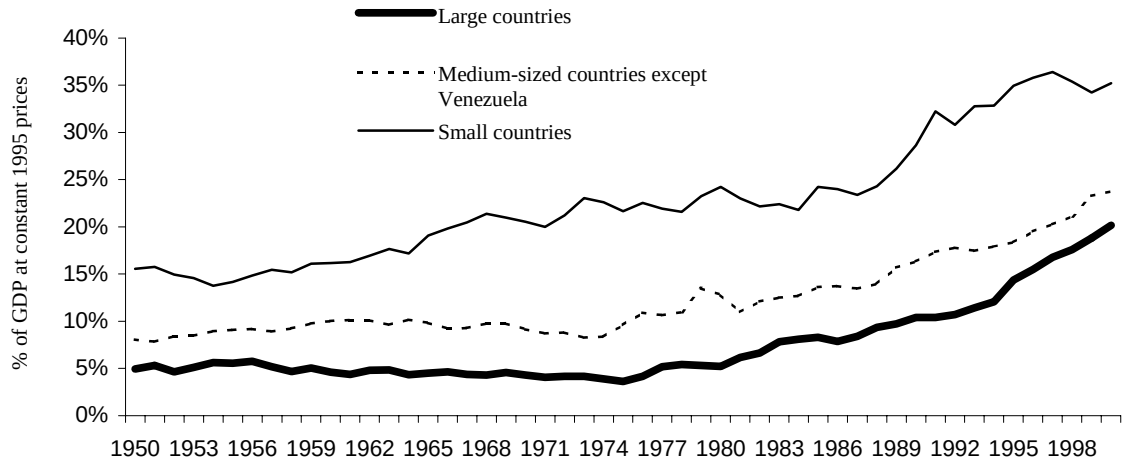
Note: The data on world imports refer to the total imports of 82 reporting countries, corresponding to approximately 90% of world trade. 1985 refers to the annual average for the period 1984-1986. 2000 refers to the annual average for 1999-2000. The countries not included as reporting countries are primarily those with economies in transition. Western Europe: European Union plus Switzerland, Norway and Iceland. Other industrialized: Japan, Australia, New Zealand and Israel. "Rest of world" is not included as a destination for lack of information. Asian origin, "Rest of world" refers to economies in transition, Oceania except Australia and New Zealand, free zones, etc.

Figure 2.2
EXPORTS FROM LATIN AMERICA

A. Percentages of GDP



B. Percentages of GDP by size of countries (simple averages)

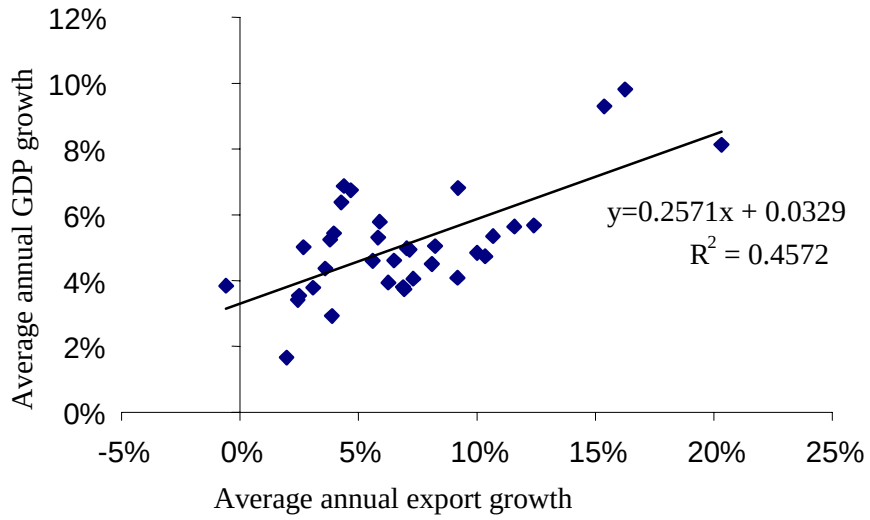


Source: ECLAC, on the basis of official figures.

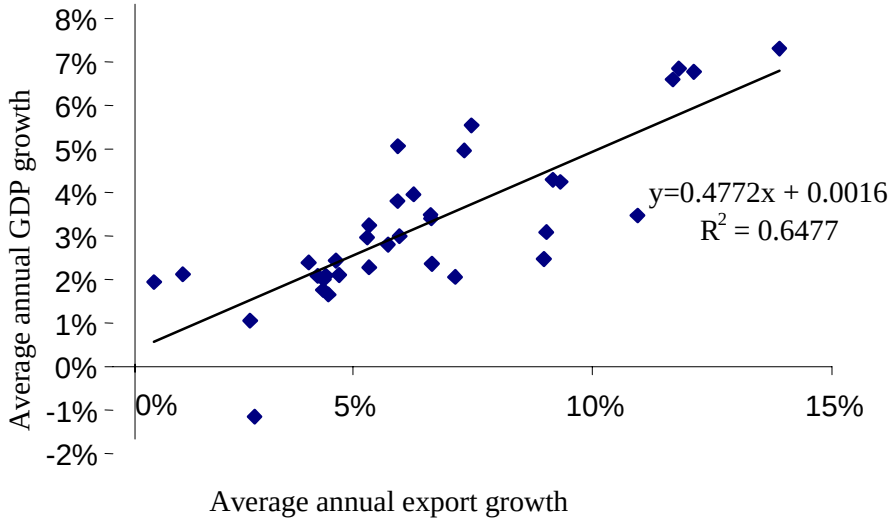
This variable relationship is confirmed by the data shown in figure 2.3. The period between 1950 and 1973 was marked by both faster GDP growth and widely varying patterns of integration into the world economy. Accordingly, the second phase of globalization was not characterized by a strong positive correlation between export growth and GDP growth in the different countries, although some of the fastest-growing economies in that period, particularly the Republic of Korea, Japan and Taiwan Province of China, were also very successful exporting economies. This correlation was, however, strengthened in the third phase of globalization. Thus, even though the liberalization and expansion of world trade **did not translate** into faster world economic growth in the third phase of globalization, the success achieved by individual countries **was** closely linked to their active participation in international trade flows.

Figure 2.3
EXPORT GROWTH AND GDP GROWTH BY COUNTRY
(*35 countries*)

A. 1950-1973



B. 1973-1998



Source: Angus Maddison, *The World Economy. A Millennial Perspective*, Paris, Organisation for Economic Co-operation and Development (OECD), 2001.

In the developing world, the relationship between development strategy, external trade and economic growth undoubtedly has varied since the end of the Second World War. Comparative analyses (see, for example, Helleiner, 1994) categorically demonstrate that trade policy has played an important role in development strategies, but also that there is no simple correlation applicable to all countries in all time periods or to a given country in different periods. The import substitution strategy yielded benefits in terms of rapid economic growth at certain stages, and was even, as

noted by Chenery, Robinson and Syrquin (1986), a prerequisite for the export of manufactures at a later stage. Nonetheless, the effects of protectionist policies tended to weaken over time. As was reflected in the global relations referred to above, in more recent decades rapid economic growth has been increasingly linked to success in the area of exports, although this has been achieved under widely varying trade policy strategies. In reality, there is no close linkage between export growth and a liberal trade regime (UNCTAD and Rodríguez and Rodrik). Moreover, as indicated in the extensive literature on East Asia (see, for example, Akyüz, 1998; Amsden, 1989 on the Republic of Korea and 2001; Chang, 1994; Wade, 1990), instances of strong economic growth have been accompanied by mechanisms for State intervention in external trade, the financial sector and technology. According to Rodrik (1999a, 2001a), rapid growth in developing countries has coincided with various combinations of economic orthodoxy and "local heresies".

In view of the increasing importance of export strength for countries' economic growth, it is essential to identify precisely the patterns which have promoted export strength in recent decades. Accordingly, table 2.2 illustrates the changes in the network of international trade flows, by origin and destination, between 1985 and 1999; the notes to the table provide detailed information on the subject. The most striking trend that can be observed is the marked increase in the Asian developing countries' share of world trade. This was achieved largely at the expense of the relative weight of trade between developed countries, which, in any case, still represents more than half of world trade. North America's share also increased as a result of the considerable expansion of its exports to Latin America and the Caribbean. Trade between developing countries also rose steadily in Latin America and the Caribbean and, even more, in the Asian bloc. In contrast, the weighted share of Africa and the rest of the world (essentially the countries of Central and Eastern Europe) continued to fall. Latin America's share of exports rose, but to a much lesser extent than its share of imports, with the result that the high positive trade balance of 1985 had become a deficit by 1999, sharply contrasting with the large trade surplus of the Asian developing countries.

The composition of world trade by category of goods has changed substantially over the past 15 years. Table 2.3 classifies products as dynamic or stagnant and indicates their relative importance in two categories of international trade: that involving the intensive use of natural resources and technology, as identified by ECLAC,[4] and the Standard International Trade Classification, known as SITC. The slow growth of trade in commodities and natural resource-based manufactures is one of the most striking phenomena in this regard. Moreover, increasing market competition has resulted in a severe deterioration of raw material prices, in a continuation of a more long-standing trend (see box 2.1). Among manufactures, those based on the use of advanced technology show a much higher growth rate than manufactures as a whole. At the same time, the share of agricultural products, non-food raw materials and, especially, fuel is declining. Lastly, the largest increases are found in the category of machinery and equipment, especially electrical equipment and equipment related to the information and communications industry, whose share increased by nine percentage points.

An analysis of the growth of international trade can be combined with an analysis of the "revealed competitiveness" of various regions, as reflected in their share of different types of products. This gives rise to four categories: (i) dynamic products in which a given region's share of trade is increasing ("rising stars"); (ii) dynamic products in which its share is falling ("missed opportunities"); (iii) stagnant products in which the region's market share is increasing ("falling stars"); and (iv) products that combine low growth with a loss of market share ("retreat products").

[4] ECLAC (1993) presents a system of classification by technology-intensiveness, in line with the SITC four-digit classification system.

Table 2.3
DYNAMIC AND STAGNANT PRODUCTS IN WORLD IMPORTS, 1985-2000
Four-digit SITC, Rev. 2 Weighted
(*% of total imports*)

	Dynamic products				Stagnant products				
	Number of items	**1985**	**2000**	**Increase**	**Number of items**	**1985**	**2000**	**Loss**	**Net increase or reduction**
A. By technological category									
Commodities	15	0.7	0.8	0.1	132	22.5	11.6	-10.9	12.3
Natural resource-based manufactures	65	5.3	6.8	1.6	134	14.3	8.9	-5.4	14.1
Low-technology manufactures	71	7.3	10.8	3.5	90	7.1	4.9	-2.2	12.2
Mid-level technology manufactures	91	16.7	21.1	4.4	111	11.8	8.6	-3.3	25.2
High-technology manufactures	45	9.5	21.6	12.2	21	2.2	1.3	-0.9	10.8
Unclassified products	4	1.4	2.8	1.4	7	1.4	0.9	-0.5	2.3
Total	291	40.8	63.9	23.1	495	59.2	36.1	-23.1	76.9
B. By SITC classification									
Food and live animals for food	17	1.1	1.4	0.3	77	7.5	4.3	-3.2	-2.9
Beverages and tobacco	4	0.3	0.3	0.1	7	0.7	0.6	-0.2	-0.1
Crude materials, inedible, except fuels	8	0.1	0.1	0.0	96	6.1	3.4	-2.7	-2.6
Mineral fuels, lubricants and related materials	2	0.1	0.1	0.0	18	17.2	8.6	-8.6	-8.6
Animal and vegetable oils, fats and waxes	3	0.0	0.1	0.0	15	0.6	0.3	-0.3	-0.3
Chemicals and related products	39	3.6	6.0	2.4	56	4.5	3.3	-1.2	1.3
Manufactured goods classified by material	76	6.5	7.9	1.4	115	9.1	6.1	-3.1	-1.6
Machinery and transport equipment	89	22.0	35.6	13.6	70	7.9	5.6	-2.3	11.3
Power generating machinery and equipment	9	1.6	2.3	0.7	10	0.5	0.4	-0.2	0.5
Machinery specialized for particular industries	6	0.9	1.1	0.2	22	1.9	1.3	-0.6	-0.4
Metalworking machinery	4	0.3	0.3	0.0	4	0.4	0.3	-0.1	0.0
General industrial machinery and equipment	16	1.9	2.6	0.7	11	1.2	1.0	-0.2	0.6
Office machines and automatic data processing equipment	7	2.4	6.0	3.6	4	0.4	0.3	-0.2	3.4
Telecommunications and sound recording apparatus	6	1.6	3.7	2.1	6	1.2	0.8	-0.3	1.8
Electrical machinery, apparatus and appliances	25	4.7	9.8	5.1	0			0.0	5.1
Road vehicles, including air cushion vehicles	8	7.6	8.1	0.6	5	1.5	1.1	-0.4	0.2
Other transport equipment	8	1.1	1.6	0.6	8	0.7	0.3	-0.3	0.2
Miscellaneous manufactured articles	52	5.8	9.6	3.9	36	4.7	3.6	-1.1	2.8
Commodities and transactions not elsewhere classified	2	1.3	2.7	1.3	4	1.0	0.5	-0.6	0.8

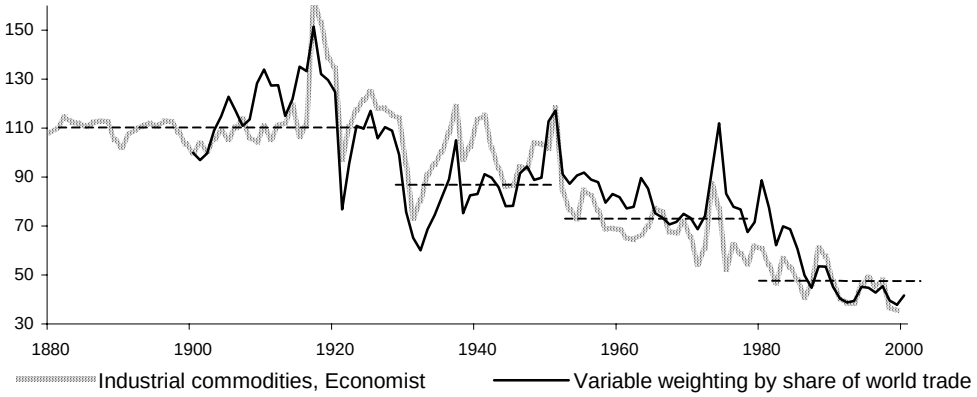
Source: ECLAC, TradeCAN 2001, on the basis of the International Commodity Trade Data Base (COMTRADE) data.

Box 2.1

THE LONG-TERM DETERIORATION OF RAW MATERIAL PRICES

The terms of trade between commodities and manufactures have a crucial effect on both short-term macroeconomic performance and the developing countries' growth prospects, owing to the importance of commodities in these countries' export structures. In the 1950s, Prebisch and Singer formulated the hypothesis of a secular trend towards a decline in the commodity terms of trade. This hypothesis has been studied in depth since then, and both its theoretical and empirical bases have been called into question. Price data for 24 commodities in the period between 1900 and 2000 show that the terms of trade for non-oil commodities have deteriorated to such an extent that they now represent less than a third of their pre-1920 levels. This is equivalent to an annual decrease of 1.5% for the past 80 years, which is evidently a significant decline.

REAL COMMODITY PRICE INDEXES, 1900=100



However, a time series analysis does not reveal a persistent downward trend, but rather three structural changes: one around 1920, when commodity prices lost nearly a third of their relative value; another at the end of the Second World War; and the last in 1980, which set off a very negative trend that has resulted in a cumulative decline of nearly 30% over the past 20 years.

Historical analyses indicate that the First World War ushered in a period of slow economic expansion in the industrialized countries, particularly the United Kingdom and other European countries, that interrupted the brisk growth which had characterized the first phase of globalization. The initial decline coincided with the severe post-war crisis of 1920 and 1921, when real raw material prices plummeted by 45%. As a consequence of overproduction in both developed and developing countries, the terms of trade improved over the rest of the decade but never again reached their pre-war levels, despite the fleeting growth spurt in the world economy and especially the United States economy. The global economic collapse of 1929 triggered another slide in the prices of raw materials, which remained low until the end of the 1940s.

Economic growth rose sharply throughout the world after the Second World War, except in the period of tension generated by the Korean War, but commodity prices stayed low. The expansion of supply hindered their recovery, despite increased demand. The 1973 oil shock marked the only time when commodity prices regained the level they had reached before the First World War, as well as the onset of a new period of slower growth worldwide.

The real turning point, however, came in 1979, when the United States economic authorities decided to raise interest rates to curb inflation and protect the value of the dollar. Since then, despite the temporary recovery of the United States in the 1990s, world economic growth has been sluggish and the developed countries have stepped up their policies of instituting protectionist measures and providing agricultural subsidies. The deterioration of the commodity terms of trade, which accelerated in this period, has not been reversed. Currently, the oversupply of commodities and the slowdown in the world economy hold out little hope for a recovery in the near future.

Source: José Antonio Ocampo and María Ángela Parra, "El retorno de un eterno debate: los términos de intercambio de los productos básicos", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2002, unpublished.

Export growth in the Asian developing countries, and especially in North America, in the 1990s was associated with the first group of products (see table 2.4). Conversely, Europe's exports reveal the increasing weight of low-growth products in which the region is losing its market share. In the group of other industrialized countries (dominated by Japan), dynamic products prevail, though with a loss of market share. The export situation of Africa is characterized by the enormous weight of stagnant products in which the region is losing its market share, and that of the rest of the world (basically Central and Eastern Europe), by the loss of market share in dynamic products.

Within these parameters, Latin America and the Caribbean is characterized primarily by the importance of less dynamic products, which, in fact, represent the largest proportion of its exports (more than three fourths in the 1990s). As will be discussed in detail in chapter 6, there are actually two dominant patterns of specialization. One is characterized by the increasing weight of exports of dynamic products (Mexico and some Central American and Caribbean countries) and the other, by the predominance of natural resource-intensive products, whose share of world trade is growing slowly (South America). The most notable change between the periods 1985-1990 and 1990-1999 was the increased market share of stagnant products, as reflected in the relatively lesser importance of "retreat" products in relation to "falling stars". In addition, as the region also increased its market share in dynamic products, the weight of the "rising stars" increased in relation to the products classified as "missed opportunities". From this standpoint, the factor which has contributed most to the growth of regional exports has not been their reorientation towards the fastest-growing products in international trade, but rather the enhancement of competitiveness within the existing export structure.

2. The emergence of internationally integrated production systems

The close relationship between international trade and FDI has been another salient feature of recent decades. The participation of developed-country firms in international trade is hardly new, but this phenomenon, which dates back at least as far as the nineteenth century, took on greater relevance after the Second World War. Historically, transnational corporations have focused on the exploitation of natural resources, sometimes coming into conflict with nationalist interests in developing countries; on the construction and management of key segments of the infrastructure supporting agriculture- and mining-based export complexes; on the provision of home services in rapidly growing urban areas; and on capturing protected industrial markets under national import substitution strategies and, in some cases, also taking advantage of incipient subregional integration arrangements.

There is evidence that the growth of international trade in recent decades, the expansion of transnational corporations and the emergence of international integrated production systems are closely related. In the literature on the subject, four factors have been proposed as determinants of the recent growth in international trade: the first two are the reduction of transport costs and trade barriers; the third is the increased demand for different brands of the same products among countries with similar income levels; and the fourth is the break-up of production chains (value chains), which has generated trade flows in intermediate products that cross national boundaries several times in the process of manufacturing a single product (Feenstra, 1998). Some recent studies have highlighted, in particular, the increased trade in intermediate products and services as part of a deepening of the international division of labour between industrialized and developing countries (Feenstra, 1998; Baldwin and Martin, 1999; and Feenstra and Hanson, 2001).

Table 2.4
EXPORT STRUCTURE BY COMPETITIVE POSITION
(*Percentage of exports in the base year and in the final year*)

	Rising stars	Missed opportunities	Falling stars	Retreat	Variation total market share
A. 1985-1990					
Western Europe					
Base year	30.7	36.7	20.5	12.1	3.3
Final year	36.5	38.9	16.7	7.9	
United States and Canada					
Base year	15.3	44.5	13.3	26.9	-0.6
Final year	22.9	47.2	11.8	18.0	
Other industrialized					
Base year	21.0	47.0	11.2	20.9	-0.1
Final year	30.9	44.1	12.4	12.6	
Latin America and the Caribbean					
Base year	11.4	20.8	23.9	43.8	-1.1
Final year	22.6	24.3	24.5	28.6	
Africa					
Base year	5.2	11.0	14.3	69.5	-1.4
Final year	13.0	18.8	20.5	47.7	-0.7
B. 1990-2000					
Western Europe					
Base year	2.7	37.9	4.8	54.5	-8.6
Final year	5.7	44.8	5.7	43.8	
United States and Canada					
Base year	31.3	13.3	32.3	23.2	2.1
Final year	43.2	14.7	28.9	13.2	
Other industrialized					
Base year	6.4	48.8	19.5	25.3	-1.5
Final year	10.4	51.3	22.0	16.3	
Latin America and the Caribbean					
Base year	18.1	2.7	57.2	22.0	1.3
Final year	37.0	2.2	49.8	11.0	
Africa					
Base year	2.5	8.6	19.8	69.1	-0.8
Final year	6.6	9.1	23.9	60.4	
Asian developing countries					
Base year	31.4	3.9	37.0	27.6	6.0
Final year	50.1	3.0	31.7	15.2	

Source: ECLAC, TradeCAN 2001, on the basis of the International Commodity Trade Data Base (COMTRADE) data.

The restructuring of the international economy has reflected, on the one hand, the extension of the logic of business and industry to all sectors of the economy, and, on the other, the development of labour specialization in business and the growth strategies adopted over time (Chandler, 1977; 1990). In business, the progressive autonomy of the components of the labour process after a given stage of production, conditions of market competition and the costs of verticalization of the production process within a single firm, together with changes in demand, have fostered the relative growth of independent suppliers of intermediate goods and services. The trend towards globalization in some industries and the establishment of "global factories" represent an attempt to reproduce, at the world level, the specialization and outsourcing practised by individual firms in local markets (Grunwald and Flamm, 1985).

The fragmentation of the production process is a form of internationalization that depends on the characteristics of the product concerned and its market. In fact, the earliest definitions of global firms referred to those in which a product was produced simultaneously, in a similar manner, in different parts of the world (Levitt, 1983; Hammel and Prahalad, 1985). Some global industries, such as foodstuffs and personal care products, are characterized by the homogeneity of their products, which are produced by similar processes in plants located in different regions. These trends have been intensified by the increasing homogenization of consumer preferences, technologies and products traded on world markets (Levitt, 1983).

Moreover, there is an interaction between the growth strategies of transnational corporations and patterns of production and competition in specific sectors, which, in turn, combine with localization factors to determine the characteristics of trade flows in products, parts and components (Dunning, 1993a). One study by OECD (1996) concluded that trade in the most science-intensive sectors (such as the pharmaceuticals industry) tends to take place within firms, whereas trade in large-scale and technologically advanced industries (automobiles and consumer electronics, among others) primarily reflects assembly operations and intraregional trade. Natural resource-intensive products show low levels of intrafirm trade, and international integration is usually horizontal, meaning that it involves trade in similar products. In the garment industry, trade flows may involve either products assembled in different parts of the world (vertical specialization) or finished products (horizontal specialization). Both types of specialization generate intra-industry trade flows, which may or may not take place within the same firm.[5]

It is important to ensure that the mobility afforded by technological progress turns subsidiaries of transnational corporations, which used to operate in a geographically dispersed manner but with self-contained production processes, into integrated production and distribution networks at the regional and global levels. Within these networks, firms can purchase the inputs they need locally and produce for the local or regional market, or they can integrate economic activities scattered among different regions. From this standpoint, the regionalization of the world economy is, paradoxically, a corollary of globalization.[6]

In trade based on the segmentation of the value chain (Krugman, 1995), countries specialize, according to their absolute advantages, in productive activities and not in industries, as suggested in international trade studies (Feenstra, 1998; Knetter and Slaughter, 1999; Rayment, 1983). Consequently, countries with a large supply of low-skilled labour do not necessarily specialize in labour-intensive industries or branches of industry, but rather in the most labour-intensive activities, which, owing to the scale of production or distribution, are under the coordination of global firms. Therefore, each stage in the manufacture of a product, such as the sewing of a garment, for example, which used to be carried out as part of a factory assembly line, has now become a manufacturing activity that takes place in plants located in countries with a large supply of unskilled labour.[7]

Changes in international trade patterns have been closely linked, therefore, to the restructuring of transnational corporations and to the upswing in foreign direct investment (FDI). The links between FDI and free trade have also been facilitated by changes in the regulatory

---

[5] The practice of producing and assembling a product in one country for subsequent re-export to the country in which the firm is based began in the late 1960s as a strategy adopted by United States firms in Asian countries. In 1966, these operations represented about 10% of the sales of subsidiaries of United States-owned firms in those countries; in 1977, they represented 25% (Grunwald and Flamm, 1985).

[6] Robert Feenstra (1998) has referred to this as the "integration of trade and disintegration of production". See also Burda and Dulosch (2000).

[7] These differences are not reflected in trade statistics, which are organized by industry. This means that they are not very useful for characterizing countries' areas of international specialization. Moreover, the same product may appear in the customs records of different exporting countries, each of which specializes in a different stage of processing the product.

frameworks governing trade and investment[8] and by other factors related to the ongoing technological and managerial revolution. The lower cost of information management, communications and transport and the use of sophisticated techniques for synchronizing production with demand ("just-in-time") have turned worldwide production, marketing and research and development into profitable undertakings (Turner and Hodges, 1992). These changes have been considerably reliant on economies of scale and environment and, ultimately, on the predominance of large firms. Likewise, agglomeration economies have encouraged the concentration of enterprises in areas that afford them easy access to global markets and factors of production, as well as innovation capacity, suppliers and appropriate institutions.[9]

Furthermore, the increasing competition faced by enterprises, the technological advances that have made it possible to establish real-time long-distance linkages and the liberalization of external trade policies have resulted in greater geographical dispersion of all business functions, even essential ones such as design, research and development and financial management. Some important manifestations of this phenomenon are the establishment of subsidiaries to serve regional markets (such as those in Singapore for the Asian market) and the international division of labour among various regions (as in the automobile sector) and continents (as in the case of semiconductors). In these complex systems, the reassigned functions encompass a wide range of activities; the simplest tasks, such as assembly, are assigned to less industrialized areas, while functions requiring specialized know-how and technology are transferred to more industrially advanced areas.

In terms of the development of business strategies, cross-border mergers and acquisitions are one of the most visible signs of globalization, especially when they involve large firms, and require considerable amounts of financial resources and wide-ranging organizational restructuring. These operations, which intensified in the second half of the 1990s (see table 2.5a), enable firms to rapidly acquire a portfolio of localized assets, which are essential for strengthening its competitive position in the local, regional or world economy. In many cases, the firm's survival is the primary strategic incentive for these operations, especially since firms that are reluctant to engage in them may run a serious risk of being absorbed or of being placed at a competitive disadvantage by the merging of rival firms.[10] There is an intense and dynamic interaction between changes in the global economic environment and the factors that induce firms to engage in cross-border mergers and acquisitions; this explains the steady increase in such operations.[11]

The combination of all these factors has resulted in a rapid increase in foreign direct investment, with a consequent increase in the weight of international production in the world economy. In the 1990s, FDI flows grew considerably, particularly in the second half of the decade, rising from an annual average of about US$ 200 million between 1989 and 1994 to more than US$ 1.3 billion in 2000. Nonetheless, in 2001, for the first time since 1991, worldwide FDI flows declined significantly, dropping to around US$ 760 million.[12] In any event, this level is equivalent

---

[8] Between 1991 and 2000, a total of 1,185 changes were introduced into national laws on FDI; 1,121 (95%) of these changes were aimed at creating more favourable conditions for FDI.

[9] Agglomerations of innovative activities, such as Silicon Valley in California (United States), Silicon Fen in Cambridge (United Kingdom), Wireless Valley in Stockholm (Sweden) and Zhong Guancum in Beijing (China), have evident advantages for attracting high-value FDI. Bangalore, India, has become a magnet for the development of computer programs, as have Penang, Malaysia, in the electronics industry and Singapore and the Special Administrative Region of Hong Kong, China, in the financial services industry.

[10] One of the most interesting examples in this regard is the strategy adopted by Spanish firms to expand their operations in a number of Latin American countries.

[11] Changes in the environment are associated with technological innovations, changes in the regulatory frameworks that influence a firm's operations and the development of capital markets. The primary strategic objectives are access to new markets, an increased share of such markets or a dominant position in them, ownership of natural resources, particularly non-renewable ones, enhancement of efficiency through the utilization of synergies, achievement of economies of scale through the firm's enlargement, hedging of risks through the diversification of activities and financial considerations (UNCTAD, 2001).

[12] The sudden drop that occurred in 2001 is attributable to a number of factors, including the reduced number of cross-border mergers and acquisitions, the slowdown in the world economy and the steep decline in stock prices, the heightened uncertainty that prevailed

to just under four times the annual average for the period 1989-1994 and exceeds the values for each year of the 1990s, with the exception of 1999 and 2000 (see table 2.5b).

Thus, between 1982 and 1999, the percentage of worldwide gross fixed capital formation represented by FDI rose from 2% to 14%, and the value added by transnational corporations rose from 5% to 10% of world GDP. In addition, sales of subsidiaries of transnational corporations grew much faster than global exports (UNCTAD, 2000). As early as the mid-1990s, it was estimated that two thirds of world trade in goods and non-factor services was derived, in some way, from the international production structure of transnational corporations.[13]

This global expansion is driven by the operations of more than 60,000 transnational corporations with nearly 800,000 foreign subsidiaries. Developed countries remain the primary source and destination of FDI flows; in 2000, 71% of total FDI came from such countries and 82% was directed to them. FDI flows have also increased significantly in developing countries, quadrupling, in 2000, their average level for the period 1989-1994 (see table 2.4). The primary recipients were Hong Kong, China and India in Asia, and Mexico, Brazil and Argentina in Latin America.

A comparison of the global distribution of inflows and outflows in 1985 and 2000 shows that FDI has become more important to more countries than in the past. FDI inflows of over US$ 10 billion are now concentrated in more than 50 countries (including 24 developing countries), compared to only 17 countries (including seven developing countries) 15 years ago. The pattern of investment abroad is similar: the number of countries with more than US$ 10 billion in investments abroad rose from 10 to 33, and currently includes 12 developing countries, compared to eight in 1985.

While FDI has expanded geographically, its distribution remains highly asymmetrical. The head offices of 90 out of the 100 largest non-financial transnational corporations, classified as such by the amount of their assets abroad, are located in the United States, the European Union and Japan. In 1999, for the first time, three developing-country firms were among the world's 100 largest (Hutchison Whampoa of Hong Kong, Petróleos de Venezuela and CEMEX of Mexico). The 50 largest developing-country firms, the biggest of which are hardly comparable to the smallest of the 100 largest in the world, are scattered among 13 newly industrialized economies in Asia and Latin America. They include firms in Hong Kong, Venezuela, Mexico, Malaysia and the Republic of Korea.

In terms of major sectors of economic activity, the most striking feature is the significant growth in services. The share of services in FDI inflows between 1988 and 1999 rose by more than six percentage points worldwide, representing over half of cumulative FDI at the end of that period (see table 2.6). This important change is essentially attributable to two factors. First, the liberalization and privatization policies adopted by developing countries in the past decade have prompted a copious inflow of FDI in financial services, telecommunications and other components of infrastructure. Second, the emergence of new marketable services (including the production of computer programs, data processing, telephone calling centres and business support services) has enabled developing countries to take advantage of localization. Moreover, organizational innovations such as "just-in-time" production require logistical and inventory management solutions that are supplied largely by independent service firms.

towards the end of the year and the strong impact of the telecommunications sector, which suffered as a result of the limited success of the introduction of the third generation of mobile telephones in Europe.

[13] According to this estimate, one third of world trade in goods and non-factor services consisted of operations between the head offices, subsidiaries and associates of transnational conglomerates, valued at transfer prices, while another third consisted of exports by transnational corporations to non-associated firms (UNCTAD, 1995).

Table 2.5
FOREIGN DIRECT INVESTMENT
(Billions of dollars)

	Average 1989-1994	1995	1996	1997	1998	1999	2000	2001
A. Cross-border mergers and acquisitions								
Total	**110.2**	**186.6**	**227.0**	**304.8**	**531.6**	**766.0**	**1 143.8**	
Sales, by region of sale								
Developed countries	94.2	164.7	188.7	234.7	445.1	681.1	1057.1	
Developing countries	10.5	16.1	34.7	64.6	80.7	73.6	70.0	
Economies in transition	5.5	5.7	3.6	5.5	5.1	9.1	16.7	
Multinational a/	-	0.1	-	-	0.7	2.2	-	
Purchases, by region of purchase								
Developed countries	103.3	173.8	198.3	272.1	511.4	706.5	1 094.0	
Developing countries	6.6	12.8	28.1	32.5	19.2	57.7	42.1	
Economies in transition	0.3	-	0.5	0.2	1.0	1.5	1.7	
Multinational a/	-	-	0.1	-	-	0.3	6.0	
B. Regional distribution of inflows and outflows								
Total FDI inflows	**200.1**	**331.1**	**384.9**	**477.9**	**692.6**	**1 075.0**	**1 270.8**	**760.1**
Developed countries	137.1	203.5	219.7	271.4	483.2	829.8	1 005.2	5 10.1
Developing countries	59.6	113.3	152.5	187.4	188.4	222.0	240.2	2 24.9
Economies in transition	3.4	14.3	12.7	19.1	21.0	23.2	25.4	25.1
Total FDI outflows	**228.2**	**355.3**	**391.6**	**466.0**	**711.9**	**1 005.8**	**1 149.9**	-
Developed countries	203.2	305.8	332.9	396.9	672.0	945.7	1 046.3	-
Developing countries	24.9	49.0	57.6	65.7	37.7	58.0	99.5	-
Economies in transition	0.1	0.5	1.1	3.4	2.1	2.1	4.1	-

Source: The author, on the basis of United Nations Conference on Trade and Development (UNCTAD), *World Investment Report, 2001* (UNCTAD/WIR/(2001)), Geneva, 2001. United Nations publication, Sales No. E.01.II.D.12.

a/ Sales (purchases) involving more than two countries.
A: Tables B7 and B8
B: Tables B1 and B2

Table 2.6
FDI INFLOWS
(Millions of dollars and percentages)

Sector	Developed countries		Developing countries		World	
	1988	1999	1988	1999	1988	1999
Primary	10.3	5.7	13.7	5.4	10.7	5.6
Secondary	39.4	36.4	65.0	54.5	42.4	41.6
Tertiary	46.9	55.5	20.7	37.3	43.9	50.3
Unspecified	3.4	2.4	0.6	2.8	3.0	2.5
Total	890,456.0	2,520,194.0	119,016.0	1,014,657.0	1,009,472.0	3,534,851.0

Source: United Nations Conference on Trade and Development (UNCTAD), *World Investment Report, 2001* (UNCTAD/WIR/(2001)), tables A.II.3 and A.II.4, Geneva, 2001. United Nations publication, Sales No. E.01.II.D.12.

Note: The data are for 47 countries in 1988 and 57 countries in 1999, which represent more than 80% of FDI inflows in both years. Eastern Europe is excluded for both years.

This process has taken place alongside the restructuring of the industrialized economies, as a result of which the relative share of services has increased to represent more than two thirds of value added in the OECD countries (OECD, 2000). Meanwhile, the share of manufacturing activities as such has declined, representing less than a quarter of the final price of goods, while the rest is made up of the service activities that come into play from the product's conception to its final marketing (Giarini, 1999). The earnings of firms classified as manufacturing firms come mainly

from sales of services; this has prompted some authors to speak of an "encapsulation" of services in manufactures.[14]

Alongside the growth in the share of the service sector and the decline in the relative share of the manufacturing sector, a pattern of high geographical concentration of technology-intensive industrial production has proliferated. Table 2.7 shows indicators of geographical concentration for a number of industries, grouped according to whether their technological level is high (semiconductors and biotechnology), intermediate (automobiles, radios and television sets) or low (food, beverages and textiles). The resulting picture is very clear: the more advanced the industry's technology, the greater its geographical concentration in a small number of countries and at the national level. This is the case of biotechnology, which is highly concentrated in certain areas of developed countries, and of the semiconductors industry, which is concentrated in those same countries and in some South-East Asian countries. The manufacture of radios and television sets is somewhat less concentrated geographically and also extends to some developing countries; this pattern is accentuated in the case of the automobile industry. Lastly, textiles and, particularly, the food and beverage industries are less concentrated in developed countries.

The predominance of developed countries as recipients of FDI flows is still based on industries with high and intermediate levels of technological advancement, but has also increased in low-technology industries, which, in 1988, were more geographically dispersed than in 1999. This trend shows that the availability of low-skilled, low-cost labour holds less attraction today for the manufacturing industry, as do opportunities for access to protected markets. In this industry, flows from some developing countries, especially in Asia but also in Latin America and the Caribbean, have increased significantly. In contrast, many countries rich in natural resources have only a marginal share in such flows, indicating that an abundance of natural resources is, by itself, insufficient for the development of enterprises that are competitive at the international level.

Table 2.7
GEOGRAPHICAL CONCENTRATION OF FOREIGN SUBSIDIARIES IN SELECTED MANUFACTURING INDUSTRIES, BY TECHNOLOGY-INTENSIVENESS, 1999
(*Share of total number of subsidiaries*)

Share of total industry	High technology		Mid-level technology		Low technology	
	Semi-conductors	Bio-technology	Auto-mobiles	Radio and television receivers	Food and beverages	Textiles
First 3 recipient countries	0.496	0.627	0.294	0.356	0.237	0.287
First 5 recipient countries	0.629	0.71	0.44	0.502	0.353	0.401
First 10 recipient countries	0.787	0.852	0.71	0.696	0.561	0.601
First 20 recipient countries	0.945	0.953	0.884	0.893	0.747	0.795
Memorandum:						
Total number of foreign subsidiaries b/	272	169	1 296	253	2 250	1 445
Total number of recipient countries	31	28	55	36	101	77

Source: United Nations Conference on Trade and Development (UNCTAD), *World Investment Report, 2001* (UNCTAD/WIR/(2001)), tables II.6, Geneva, 2001. United Nations publication, Sales No. E.01.II.D.12.

a/ Calculated as a proportion of the total number of each industry's foreign subsidiaries throughout the world.
b/ Only subsidiaries identified as primarily foreign-owned.

[14] According to the relevant data, more than 50% of the earnings of IBM and Siemens come from service activities (Howells, 2000).

3. Outstanding challenges posed by the relationship between trade and economic growth

In the last 15 years the relationship between export performance and economic growth has raised a number of issues for developing countries. The countries' possible responses to these represent major challenges for the future, of which three are discussed here. First is the question of how to translate export competitiveness into rapid economic growth more effectively. Historically, the periods of greatest export expansion have tended to coincide with lacklustre economic growth, especially in Latin America and the Caribbean (see figure 2.4). In fact, export and output growth is more asymmetric in the region than in the world as a whole. This is largely attributable to the combined effects of rapid trade liberalization and the pursuit of macroeconomic policies based on a concept of stability that is limited to control of inflation and of the public deficit, which do not take account of significant repercussions for the real economy (see chapter 5). One of the consequences of this combination has been a structural deterioration in the economic growth/trade balance ratio (see figure 2.4). This trend is exhibited by virtually all developing countries, as discussed in Trade and development report, 1999 (UNCTAD), and largely accounts for the fact that trade growth has not yet provided these countries with the expected economic growth.

Aside from the fact that an inadequate macroeconomy is at the root of many of the problems linked to poor economic growth, a second challenge is to overcome the restrictions inherent in the production structure, in order to achieve high and sustained rates of economic expansion. Although the region has increased its share of world markets and of foreign investment flows, the production linkages associated with these have been weak. Furthermore, growing use of imported intermediate and capital goods —a typical feature of integrated production systems in globalized sectors of the economy— has resulted in the disintegration of production chains and of domestic systems of innovation that were established during the previous stage of development. These have not been replaced, or at least not at a comparable pace. In addition, the region has only a small stake in sectors associated with expanding international trade, especially those involving a large technological component (see chapters 6 and 7).

Consequently, dynamic activities have acted as only weak and intermittent multipliers and generators of technological externalities. In turn, poor trade balances have helped to keep external borrowing requirements high, even in times of recession. In a context in which expanding sectors generate an inadequate knock-on effect and world economic growth is sluggish, the structural heterogeneity (economic dualism) of production sectors has become more marked: there are now many more "world-class" firms, many of which are subsidiaries of transnational corporations, while a growing proportion of employment is concentrated in low-productivity informal-sector activities, which account for seven of every 10 new jobs created in Latin American urban areas in the last decade.[15]

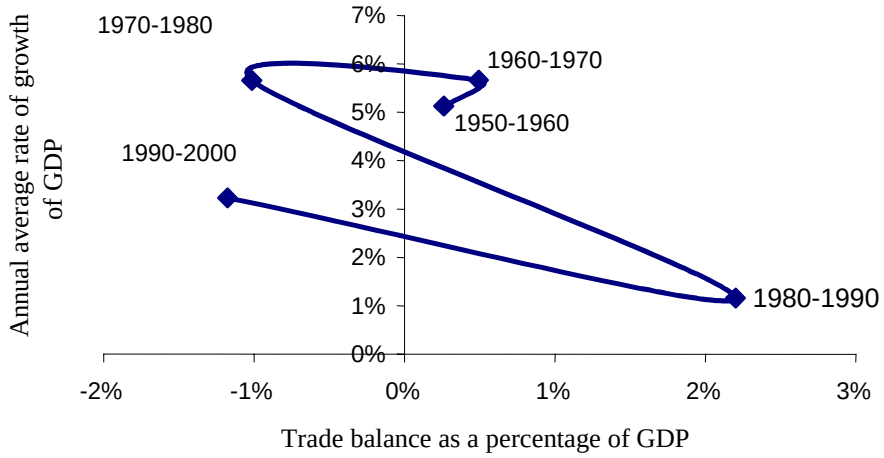
Indeed, the third challenge facing the region's countries concerns recent employment trends. There is no question that the structure of employment undergoes substantial changes in the course of the development process. In the manufacturing sector, it first tends to increase, then stabilizes and finally trends downward as per capita income rises. This pattern is consistent with the "inverted U" propounded by Rowthorn (1999).

[15] Chapters 6, 7 and 10 of this publication and ECLAC (2001a), Katz (2000) and Mortimore and Peres (2001) analyse these issues in greater depth.

Figure 2.4
TRADE AND GDP IN LATIN AMERICA, 1870-1998

A. Growth rates

B. Trade balance and GDP growth



Source: Angus Maddison, *The World Economy. A Millennial Perspective*, Paris, Centro de Estudios de Desarrollo, Organisation for Economic Co-operation and Development (OECD), 2001.

Palma's analysis (2002), which is based on a wide sample of countries, not only confirms this trend, but also introduces three striking new elements, two of which are illustrated in figure 2.5a. One of these is the continuous downward curve seen over the last four decades, which indicates a decrease in the share of manufacturing in total employment at all levels of per capita income. The author attributes this trend to the fact that productivity has increased more rapidly than GDP, which implies that employment in manufacturing has expanded at a slower pace and, in some cases, has contracted in absolute terms.[16] The second interesting element is a shift in the point of inflection to

[16] For example, in the European Union manufacturing employment decreased by almost a third in just three decades, from 1970 to 2000, while in the United Kingdom it fell by half in the same period.

lower levels of per capita income from 1980 onward. This means that the point at which the share of manufacturing in total employment begins to decrease is located at progressively lower levels of per capita income. In 1990, more than 30 countries recorded per capita income that was higher than the level at which manufacturing employment began to decrease. The services sector exhibits a very different trend, with productivity growing much more slowly than GDP, with the result that employment in the sector has increased its share of the total.[17]

The third new element points to the need to consider the phenomenon of "Dutch disease" from a fresh perspective.[18] First, the point must be made that the ratio between the share of manufacturing in total employment and per capita income is a function of the international trade pattern. Both developed- and developing-country exporters of raw materials or services, especially financial services and tourism, thus exhibit a lower ratio than exporters of manufactures at all levels of per capita income (see figure 2.5b).

Second, although these countries are usually less industrialized than exporters of manufactures, this does not alter the general trend towards de-industrialization in either group. In fact, as figure 2.5c shows, from 1960 to 1998 manufacturing employment as a proportion of the total decreased by half in both groups of countries: from 39% to 21% in exporters of manufactures and from 29% to 16% in exporters of natural resource-based goods or services. The point of inflection on the respective curves also shifted to a level of per capita income equivalent to half (from US$ 18,000 to US$ 9,000 in that period).

"Dutch disease" should thus be understood as an "excess of de-industrialization" owing to a change in the reference group. This occurred in the Netherlands, the United Kingdom and Norway, as well as Greece, Cyprus and Malta (tourism) and Switzerland, Luxembourg and Hong Kong (financial services). Lastly, none of these considerations give substance to the proposition that has been denominated the "curse of natural resources". In fact, a number of countries such as Finland, Malaysia and other Asian countries, all of which have a large endowment of natural resources, have been able to avert this phenomenon, either by carrying forward the industrialization process using the resources available or by developing a complementary manufacturing industry for the domestic market and for export. This shows that, although opportunities exist, there are apparently increasingly fewer countries prepared to take advantage of them.

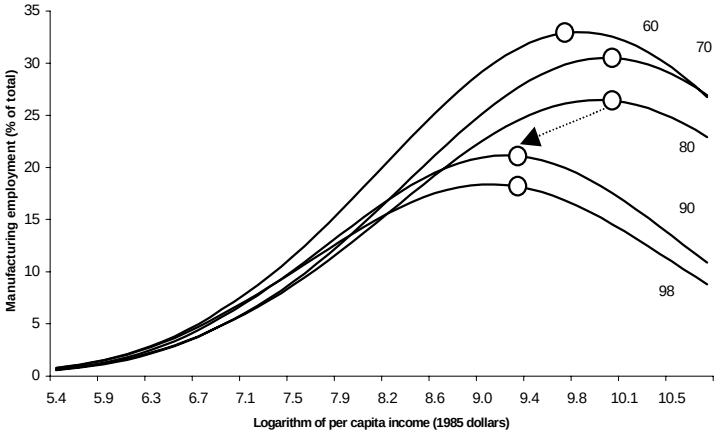
One of the striking features of Latin America and the Caribbean is that whereas before the economic reforms the ratio of manufacturing to total employment was similar in most of the countries of the region, marked divergences emerged subsequently (see figure 2.5d). Brazil and the three Southern Cone countries (Argentina, Chile and Uruguay) exhibit the highest degree of de-industrialization following economic reform; they conform to the typical pattern of raw-materials exporters, of which Venezuela is a classic example. The second pattern corresponds to a number of Central American and Caribbean countries (El Salvador, Honduras and the Dominican Republic), in which manufacturing employment has increased considerably as a result of their active involvement in assembly activities. Lastly, in Mexico, Costa Rica and the other Andean countries (Bolivia, Colombia, Ecuador and Peru), economic reform did not significantly alter the share of manufacturing employment in the total, which implies that these countries have not been affected by either "Dutch disease" or the assembly activities which have had a heavy impact on other economies.

[17] This is also true of the European Union, in which the productivity of the services sector has increased at less than half the rate of GDP growth (1.1% and 2.6%, respectively), since 1973.

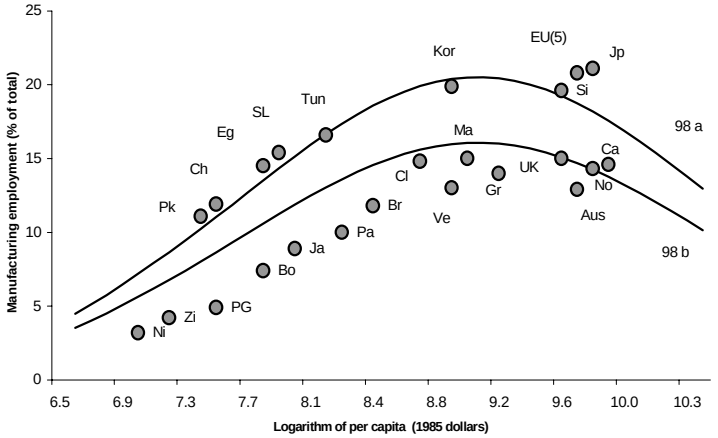
[18] "Dutch disease" usually refers to a sharp appreciation of the local currency as a result of the discovery of internationally tradable natural resources.

Figure 2.5
DE-INDUSTRIALISATION, FOREIGN TRADE, EMPLOYMENT AND INCOME

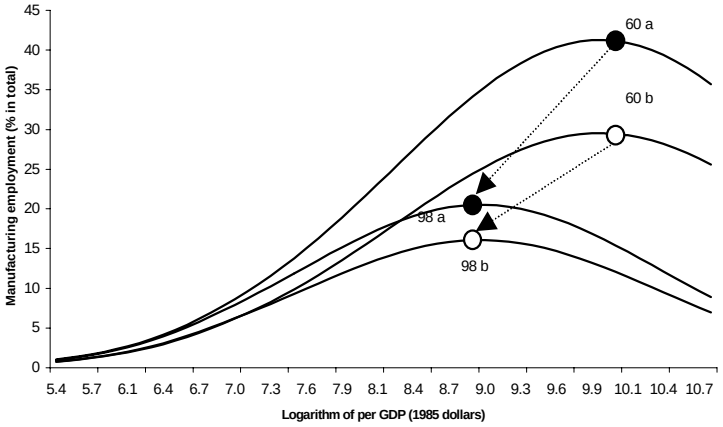
A. Sources of de-industrialization



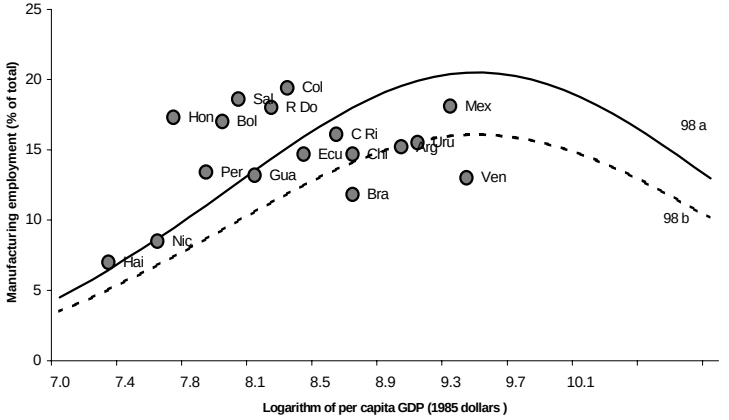
B. Foreing trade effect



C. Changes in employment and income, 1960 and 1998



D. Latin America and the Caribbean, 1998



Source: Gabriel Palma, *Three Sources of 'De-industrialisation' and a New Concept of the Dutch Disease*, 2002.

4. Development of the institutional framework for international trade

Such was the scale of the new international institutional framework that grew up after the Second World War that it marked a turning point in trade and financial history. Economic transactions had obviously begun to expand and bring about changes in international relations in the nineteenth century, including the principle of "most favoured nation" in trade agreements —which was widely transgressed in the 1930s— and recourse to international arbitration to settle disputes between States. This was followed by the adoption of the gold standard by an increasing number of countries, although this reflected gradual adherence to a system headed by the leading international power of the time, rather than the implementation of principles of international cooperation. The process was restricted to weak forms of cooperation between the main central banks of the industrialized countries (Eichengreen, 1996, chap. 2). In the nineteenth century, a number of conventions were signed and specialized agencies established, including the World Health Organization and Pan American Health Organization, the Universal Postal Union and the Paris Convention on patents for inventions, but the most significant step in terms of international cooperation came later with the creation of the League of Nations in 1919. None of these processes, however, matched the scope of the international cooperation seen after the Second World War.

The period in which the international institutional framework developed most prolifically —the final years of the war and those immediately following— was characterized by a vision reflected, firstly, in the founding of the United Nations. In the economic domain, this led to the establishment of three key institutions: the International Monetary Fund (IMF), which was to restore multilateralism in current operations and provide financial support in times of crisis; the International Trade Organization, which was to oversee the development of multilateral trade principles; and the International Bank for Reconstruction and Development or World Bank, which was to facilitate the reconstruction of countries devastated by war. When the attempt to create the International Trade Organization failed, following the Havana Conference of 1948, the role it was intended to perform passed to the General Agreement on Tariffs and Trade (GATT), which had fewer members.

With respect to trade, there were two major counterweights to the strengthening of multilateralism. The first was the formation of regional blocs, within whose borders trade expanded rapidly. The European Economic Community was the most striking example, and a number of agreements were established on a smaller scale, including several in Latin America. The former Council for Mutual Economic Assistance (CMEA) also served to boost trade among the centrally planned economies.

The second counterweight to multilateralism was widespread recourse to protectionism in the developing world. This took the form not only of high tariffs, but also of quantitative restrictions, domestic content requirements for assembly industries and minimum export requirements for firms and industrial sectors with foreign exchange shortages. For newly independent countries, protectionism amounted to an expression of autonomy, as the colonial past was perceived as an era of economic failure that had to be overcome by means of deliberate action on the part of the State. By contrast, in Latin America the increasing use of interventionism and protection represented something that was perceived as a success. In fact, in the early stages of the import substitution period, between the two world wars, the region had achieved rapid economic growth, which facilitated a relatively easy transition from export-based development to "inward development" (see table 2.8).

Table 2.8
GDP GROWTH: WORLD AND LARGEST REGIONS, 1820-1998
(Weighted average annual growth rates)

	1820-1870	1870-1913	1913-1950	1950-1973	1973-1998
Western Europe	1.65	2.1	1.19	4.81	2.11
United States, Australia, New Zealand and Canada	4.33	3.92	2.81	4.03	2.98
Japan	0.41	2.44	2.21	9.29	2.97
Asia (not including Japan)	0.03	0.94	0.9	5.18	5.46
Latin America and the Caribbean	1.37	3.48	3.43	5.33	3.02
Eastern Europe and the former Soviet Union	1.52	2.37	1.84	4.84	-0.56
Africa	0.52	1.4	2.69	4.45	2.74
World	0.93	2.11	1.85	4.91	3.01

Source: ECLAC, calculations based on Angus Maddison, *The World Economy. A Millennial Perspective*, Paris, Organisation for Economic Co-operation and Development (OECD), 2001.

In addition, in the period between the two wars, development and industrialization were considered to be one and the same, and interventionism and State planning were standard practice worldwide, with few exceptions. In several cases, this represented an extension of the strict public control imposed during periods of conflict. Consequently, in the developing world the choice that was perceived were not between State planning and free markets, but rather between central planning and the weaker forms of planning typical of mixed economies.

There were also some notable exceptions to trade liberalization in the framework of GATT. In fact, the first six rounds of negotiations promoted the liberalization of intra-industrial trade in the developed economies, while the areas requiring internal adjustments on the part of the industrialized countries —including the agricultural and textile sectors— remained outside the multilateral trade rules. These rounds reduced levies on imports of non-agricultural products from developed countries to a low average level.[19] From the late 1960s on, and in parallel with the lowering of tariffs, the multilateral trade agenda focused on other public policies affecting competition between domestic and imported goods, such as administrative barriers, technical standards and contingent protection measures (safeguards) and trade protection (anti-dumping and subsidies), many of which came to be used for openly protectionist purposes. Voluntary export restraints, which became more widespread in the 1970s and 1980s, added to the use of protectionist instruments employed outside the GATT framework.

The Uruguay Round (1986-1994) was unquestionably the most comprehensive of all the rounds of multilateral trade negotiations. The countries agreed to lower the effective average level of industrial tariffs even further. In addition, the number of duty-free tariff lines was increased, virtually all the tariff structures were bound and stricter trade remedies were adopted. With respect to issues that had previously remained outside the GATT framework, commitments were established for the agricultural sector, not only to protect trade but also in relation to export and production subsidies; agreement was reached on the gradual dismantling of the Multifibre Arrangement; voluntary export restraints were prohibited; and it was agreed to eliminate trade-related investment measures (domestic content or export requirements), which were used liberally by many developing countries. In addition, the mandate of the World Trade Organization, the successor of GATT, included two new areas: liberalization of services and international rules on the protection of intellectual property. Moreover, a new dispute settlement mechanism was created.

[19] The Kennedy Round (1963-1967) was the first in which an agreement was reached on effective tariff reductions, covering nearly 35% of overall reductions for non-agricultural products, which represented 80% of dutiable trade (Winham, 1986).

More than seven years after the entry into force of the Marrakesh Agreement establishing the World Trade Organization, there is a broad consensus among the member countries that the proper functioning of WTO is important for the orderly conduct of international economic relations. WTO has fostered the settlement of trade disputes through mutually beneficial cooperation between countries and, as a result, has helped to create a framework of trade regulations that is more reliable and predictable than those of the past. The fact that developing countries have made increasing use of the WTO dispute settlement mechanism demonstrates the importance of the Organization's active role in upholding the system of standards as an arbiter in trade conflicts.

There is a serious imbalance, however, in the distribution of the benefits deriving from the Agreement. The developed countries have continued to gain the most from the liberalization of trade in goods and services.[20] First, these countries were able to reduce the costs of adjusting their agricultural and textile sectors, since they obtained generous transition periods to more open and competitive markets. In addition, they introduced varying degrees of flexibility into the regulations that impinged on their policies on agriculture and on certain industries. They extended the GATT rules, which originally referred only to products, to cover the rights of private agents (firms), and brought into the multilateral trading system those areas in which they enjoy a solid technological predominance, including the protection of intellectual property rights. Although there are no specific agreements on investment and the protection of competition, the industrialized countries obtained national treatment for transnational corporations through the commitments on investments, subsidies and trade in services. Furthermore, they achieved a firm legal basis for the liberalization of some sectors and modalities of service provision, such as financial services, basic telecommunications, electronic commerce and information technology products. By contrast, despite the commitments undertaken, those sectors that are of interest for the exports of developing countries have not only been slow to liberalize, but have often done so in conjunction with measures that undermine existing obligations. This has been exacerbated by new forms of protectionism, such as anti-dumping measures.

This asymmetry in the distribution of benefits and the slow progress made since the 1960s in terms of special and differential treatment prompted the developing countries to seek a new round of trade negotiations would focus on areas of particular interest to them (chapter 3 analyses this issue in greater depth). The commitment to develop measures to address this situation forms the basis of the Doha Declaration, which was adopted at the Fourth World Trade Organization Ministerial Conference (Qatar, November 2001), and lays out the work programme of WTO. This programme covers several areas of interest for the multilateral trading system.[21] A process of study and negotiation lasting until 2005 will be conducted to review, broaden or alter the rules established at the Uruguay Round.

II. International finance and the macroeconomic regime

1. Historic transformations in the international financial system

The expansion of international trade in the nineteenth and early twentieth centuries was accompanied by growth in international finance and the consolidation of the gold standard as a system of international payments and macroeconomic regulation. This expansion required the development of a system of financing instruments and payment instruments for commercial transactions (bills of exchange and suchlike), and an international network of branches of large

[20] See, among others, Finger and Schuknecht (1999), François, McDonald and Nordström (1996), Thomas and Whalley (1998) and UNCTAD/WTO (1996).

[21] This agreement was reached after the failure of the Third Ministerial Conference (Seattle, 1999). The work programme established is set forth in the "Ministerial Declaration" (WT/MIN(01)/DEC/1 of 14 November 2001). This text and other declarations and final decisions of the Fourth Conference are available for consultation on the WTO web site (www.wto.org).

European and United States banks grew up around this system. Long-term financing instruments developed at the same time, including both public debt bond issues and private financing instruments. One of the main types of private financing was the floating in financial centres of shares in infrastructure projects, especially railway and mining ventures. These modalities of private financing were conducted by newly created corporations that dealt in capital in an international financial centre, but operated beyond its borders. The first transnational corporations, especially in the natural resources sector, emerged a little later but developed rapidly, and by the early twentieth century were a well-established feature of the international scene.

The gold standard was consolidated by a process of voluntary adherence in the last three decades of the nineteenth century, on the basis of pre-existing monetary systems that were based on other metals. The key element of the expansion of the monetary base was the fiduciary money issued by central banks, which were generally fully or largely privately-owned and acquired monopolies over the issue of currency (sometimes after a period of unrestricted issues) in exchange for services rendered to the State. The system therefore consisted of convertible paper money backed only partially by gold reserves and, further away from the financial centres, by holdings of foreign currency; that is, the currency issued by these centres. The stability of the system relied on the maintenance of the currency's convertibility into gold. This was necessary to avoid a run on the central bank's reserves, which would obviously be insufficient. In addition, a banking system began to operate with minimum legal reserve requirements that provided only partial backing for deposits, and for notes in economies and periods in which free stipulation was permitted. This could pose the risk of a domestic financial crisis, in the event that problems experienced by one entity triggered loss of confidence in others, or even throughout the banking system. The systemic effects of such "contagion" led to the belated assignment of another function to the central banks: as lenders of last resort to commercial banks (Eichengreen, 1996).

In order to sustain confidence in convertibility, the "rules of the game" of the gold standard required a procyclical approach to macroeconomic policy in times of difficulty: in the event of a balance-of-payments shortfall, central banks were obliged to raise discount rates to generate contractionary pressures; if the misalignment persisted the outflow of gold eroded the monetary base, which had to be translated into a smaller volume of money and therefore lower demand; lastly, fiscal deficits were limited to the financing available and governments were therefore forced to pursue austerity policies in response to lower levels of financing and a likely decrease in tax receipts in periods of crisis. As indicated by Triffin (1968) and further substantiated by more recent studies (Aceña and Reis, 2000), this system operated in an asymmetric manner, to the detriment of countries on the periphery of the system, which were both exporters of raw materials, whose prices tended to fall in times of economic turmoil, and importers of capital, whose inflows behaved in a procyclical manner. The "rules of the game" thus generated strong pressures in these cases, which explain the frequent periods of inconvertibility seen in the peripheral countries, including several Latin American economies, during the crises of the late nineteenth and early twentieth centuries.

The European countries themselves abandoned the gold standard en masse during the First World War. It proved difficult to reinstate in the 1920s and was finally abandoned during the depression of the 1930s. The dual tensions generated between austerity policies and social pressure in the countries during difficult times, on the one hand, and between the central banks' responsibilities as monetary regulators and as lenders of last resort, on the other, finally spelled the end of this system in the developed countries.

The collapse of the gold standard was followed by an episode of genuine macroeconomic anarchy at the international level, marked by exchange-rate instability and, especially, by widespread and discriminatory exchange controls. This was exacerbated by the breakdown of international financing. The First World War had raised the profile of New York as a new international financial centre. The centre's expansion in the 1920s and subsequent collapse in 1929,

in combination with widespread moratoria in the 1930s, caused long-term international financing to disappear almost completely. This was followed by the economic impact of the Second World War and, in particular, by sharp structural imbalances between the United States and Western Europe, which gave rise to a chronic "dollar shortage".

This was the context of the international cooperation efforts that began with the Bretton Woods agreements adopted in 1944. These efforts were channelled in two directions. First, notwithstanding the rejection of the ambitious proposals of Lord Keynes, a new international system of macroeconomic regulation was established. This was intended to surmount the problems of both the gold standard and the chaotic period following its demise. The new system was built on three pillars. The first was a system of fixed but adjustable parities with respect to an international standard (known as the gold-dollar, as the parity between the two was fixed). The second pillar was the provision of exceptional financing for countries that slipped into deficit in times of crisis, on the condition that they made commitments to economic adjustment, which could include exchange rate variations. This unprecedented combination of adjustment and international support was intended to prevent economic turmoil from spreading to the rest of the world through reduced demand for imports, excessive devaluation, increased protectionism and, in particular, the current payments restrictions that would likely ensue. The third pillar was a return to the principle of convertibility and non-discrimination in current payments, although no commitments were made on capital convertibility, and control of capital movements was accepted as legitimate international practice.[22] This element of the system released domestic policies, especially monetary policy, from the limitations that the free movement of capital could place on the pursuit of full employment. The resources used by IMF to fund its exceptional financing programmes came initially from the contributions of member countries, in addition to credit lines that were granted to some developed countries from 1962 on (General Arrangements to Borrow) and issues of a strictly international reserve currency, special drawing rights, in 1969; these issues have been repeated twice, the last time in 1981.

Secondly, the post-war financial reforms gave rise to new forms of long-term international financing. In response to the scarcity of private financing, official banking came to perform this role, through both the World Bank and later the regional development banks and domestic export-import banks. The Marshall Plan and, subsequently, official aid for developing countries acted as complementary means of long-term financing.

Although the official banks played a key role in financing for trade, private banks continued to perform this role even in the most fraught periods of the international payments system. The dollar surpluses generated by the United States' persistent external deficits in the 1960s —which succeeded the initial "dollar shortage" more quickly than expected— and by the petrodollars of the 1970s were recycled to provide the resources for a new phase of expansion in private international financing. The privileged position they had acquired afforded private banks a key role in this recycling process.

It is widely accepted that the dollar surplus also undermined the applicability of the Bretton Woods agreements. The dollar-gold parity was abandoned in 1971 and the major currencies were floated, which rendered the first pillar of the agreement obsolete and profoundly altered the third. The new principles were not the result of explicit international agreements, but a consequence of the facts, and they were certainly not established by means of broad negotiations like the Bretton Woods accords. The first pillar was replaced by a provision giving countries the autonomy to define their exchange regimes. The countries took very different approaches to managing the new risks posed by exchange-rate instability. The European Community attempted to reduce fluctuations

[22] Article VI of the IMF Articles of Agreement provides that: "Members may exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions".

among its members' currencies by affording priority to economic integration above all other objectives. This marked the beginning of a process which lasted a quarter of a century and culminated in monetary union among most of its members, the final stage of which was the replacement of national currencies with the euro on 1 January 2002. The developing countries espoused a number of strategies, often adopting one of the major currencies as a reference, or diversifying risks by linking their exchange rate to a currency basket.

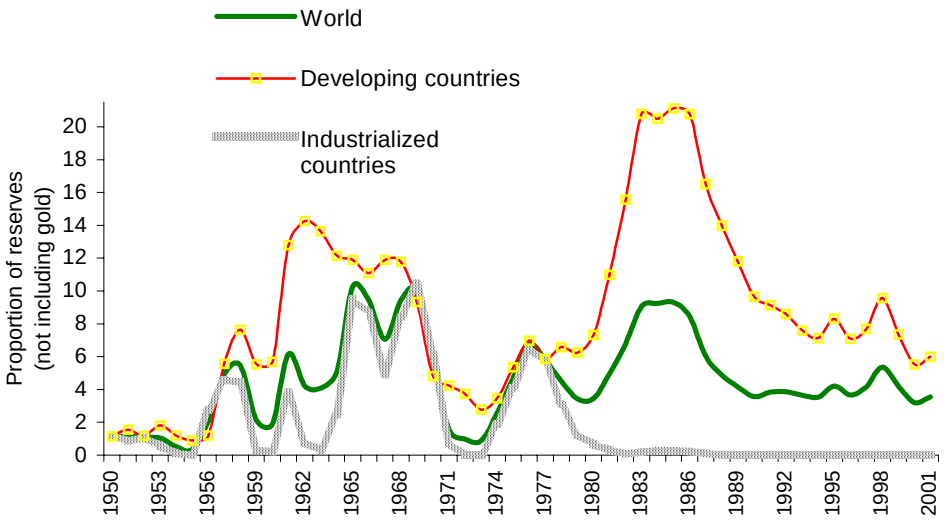
The floating of the major currencies represented a genuine "privatization of exchange risk", which generated a need for financial instruments to cover this risk and multiplied currency transactions. The ratio of currency transactions to the value of international trade increased sharply: from 2:1 in 1973 to 10:1 in 1980 and 70:1 in 1995 (Eatwell and Taylor, 2000). This, in combination with the strong expansion of international banking, profoundly altered the third pillar of the Bretton Woods accords. In practice, the liberalization of capital flows became the norm in the developed countries, which one by one eliminated controls of capital transfers in the 1970s and 1980s. A number of developing countries followed suit. The convertibility of the capital account was, in fact, meant to be enshrined at the 1997 annual meeting of IMF in Hong Kong. The explicit formulation of this principle was postponed, however, following a series of financial crises in a number of Asian countries, which have not yet come to an end. The principle of capital account convertibility has given way to the gradual liberalization of the capital account and of domestic financial sectors, in a process that has been conducted in a sequential manner, in conjunction with the development of a parallel institutional structure, in an attempt to ensure domestic financial stability. As will be discussed later, this has resulted in the emergence of new responsibilities for the Bretton Woods institutions.

The second pillar of the Bretton Woods agreement also saw substantial changes, for two reasons. First, IMF financing to developed countries, which has been very significant, was suspended at the end of the 1970s (see figure 2.6). The Fund's operations therefore came to target mainly developing countries and, increasingly, countries in which they were likely to have "systemic effects". Second, demand for resources grew, owing both to the structural nature of certain balance-of-payments problems which emerged during the crises caused by sharp hikes in petroleum prices and exacerbated during the debt crisis of the 1980s, and to capital account volatility in the 1990s. The need for larger volumes of funding for longer periods of time led to the establishment of new lines of IMF financing in the final two decades of the century. In 1979, the World Bank embarked on its structural adjustment programmes. These came to take precedence over the traditional lines of financing for projects financing which had previously been the focus of its credit strategy.

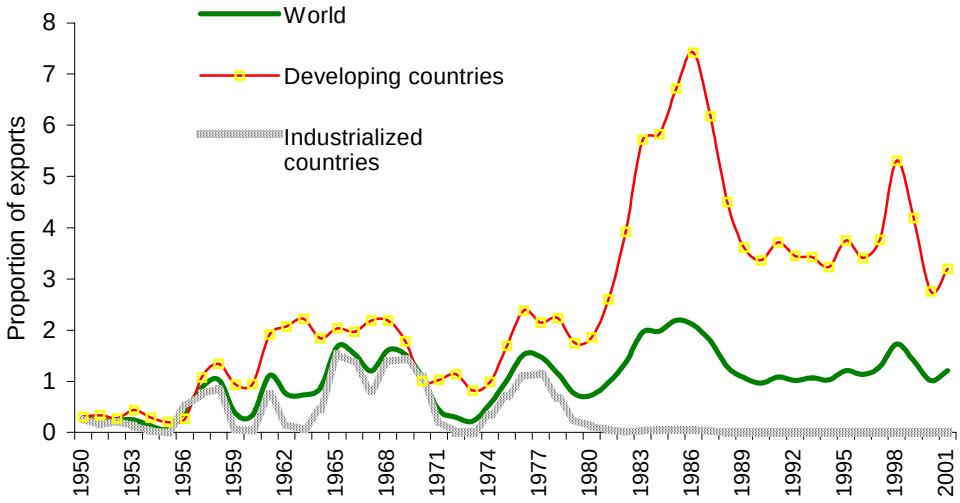
New conditionalities grew up around these changes and generated, in practice, a new function which was not contemplated in the Bretton Woods accords, and which was undertaken jointly by IMF and the World Bank from the 1980s on: the promotion of economic liberalization in the developing world, on the assumption that structural rigidities were caused by over-intervention on the part of the State. Like others before it, this new shift in the responsibilities of the Bretton Woods agencies did not arise from an explicit negotiation; clearly, it was a response to the ideological conditions and power relationships that were prevalent at the global level.

Figure 2.6
INTERNATIONAL MONETARY FUND: TOTAL CREDITS AND OUTSTANDING LOANS, 1950-2001

A. Proportion of international reserves



B. Proportion of exports



Source: International Monetary Fund (IMF), *International Financial Statistics*, Washington, D.C., CD-ROM version, December 2001.

It has been acknowledged since the 1970s that the growing internationalization of finances has generated a need for new regulatory standards. In response, in 1975 the Basel Committee on Banking Supervision was established under the auspices of the Bank for International Settlements. The most significant achievement of this initiative was the adoption in 1988 of the Basel principles on the regulation and supervision of banks. A number of reform proposals have been made since 1999, aimed at bringing the Basel principles into line with developments in the global banking industry and the shortcomings that were identified in the previous system.[23] In practice, the definition of minimum regulatory principles has extended to a much wider range of issues, including rules on debt issues in financial markets, the insurance industry and financial accounting. One of the elements of this reform, which has been broadly backed in recent years, is the creation of a programme to strengthen financial systems in developing countries, including the adoption of these international standards, and of principles for the management of external and public debt and international reserves. This new function of the Bretton Woods institutions has not been clearly differentiated from the responsibilities of other agencies, particularly the Bank for International Settlements.

2. Changes and recent episodes of volatility in financial markets

Developments in the macroeconomic environment have been accompanied by profound alterations in the financial systems of industrialized countries, which began in the 1980s and were consolidated in the 1990s.[24] This process may be summarized in terms of three basic trends. The first is the concentration of financial systems in the developed economies.[25] In the 1990s the world's main private financial institutions embarked on an intensive process of mergers and acquisitions, which became the hallmark of the decade, increasing in pace as the decade drew to a close.[26] Banking institutions therefore declined in number in almost all countries and banking concentration, calculated on the basis of the proportion of deposits controlled by the largest banks, tended to increase. In fact, this trend would be even more marked if operations off the balance sheet could be calculated.

Second, there has been a widespread trend towards banking disintermediation and an "institutionalization of savings", which is associated with the emergence of non-bank financial intermediaries, such as mutual and pension funds, investment banks and insurance companies (see table 2.9). Competition from these agents has chipped away at the predominance in international financial intermediation enjoyed by the banks in the 1960s and 1970s. It has also obliged traditional banking institutions to become conglomerates offering an ever broader range of financial services. As a result, the distinction between bank and non-bank roles has become increasingly blurred.

The activities of non-bank intermediaries were deregulated in the 1980s and this, in combination with the elimination of capital controls in developed countries, allowed these institutions to claim a growing stake in the international financial markets and a role in their expansion. This translated into considerable growth of secondary markets for debt instruments. In common with stock markets, the secondary debt markets appreciated in value thanks to the increased participation of institutional investors and of a large number of individual financial agents. This generated a virtuous circle which helped to generate new sources of financing for a relatively long period, until the trend was broken by the outbreak of international turmoil in 2000.

---

[23] Criticism has been levelled at the procyclical effects of regulation, which the new proposals tend to accentuate, and their adverse effects on risk markets, including emerging countries. See Reisen (2001a) and Griffith-Jones and Spratt (2001).

[24] See, among others, Franklin (1993), Feeney (1994), Bloomstein (1995), Culpeper (1995), D'Arista and Griffith-Jones (2001) and Group of Ten (2001) for a more detailed account of the changes in the financial systems of the main industrialized economies.

[25] Group of Ten (2001) contains a comprehensive analysis of the causes and consequences of this process.

[26] Most of these mergers and acquisitions —70% in fact— correspond to banking institutions. In addition, joint ventures and strategic alliances between institutions increased significantly.

Table 2.9
FINANCIAL HOLDINGS BY INSTITUTIONAL INVESTORS a/
SELECTED OECD COUNTRIES
(*Percentage of GDP*)

	1992	1994	1996	1999	2000
Australia	61.6	65.9	92.4	127.9	131.2
Canada	68.6	80.2	92.1	112.7	111.3
France	61.9	71.8	86.6	125.4	133.3
Germany	34	41.3	50.6	76.8	79.7
Hungary	2.5	3.9	6.1	10.7	12.8
Iceland	55.3	66.7	79.6	111.3	110.1
Italy	21.8	32.2	39	96.9	
Japan	78	81.6	89.3	100.5	
Republic of Korea	51.8	53.7	57.3	88.5	72.6
Luxembourg	1,574.3	1,945.6	2,057	4,172.3	
Netherlands	131.5	144.5	167.6	212.8	209.6
Spain	21.9	32.3	44.3	65.4	62.1
United Kingdom	131.3	143.8	173.4	226.7	
United States	127.2	135.9	162.9	207.3	195.2

Source: Organisation for Economic Co-operation and Development (OECD), *Institutional Investors Statistical Yearbook, 2001*, Paris, 2001.

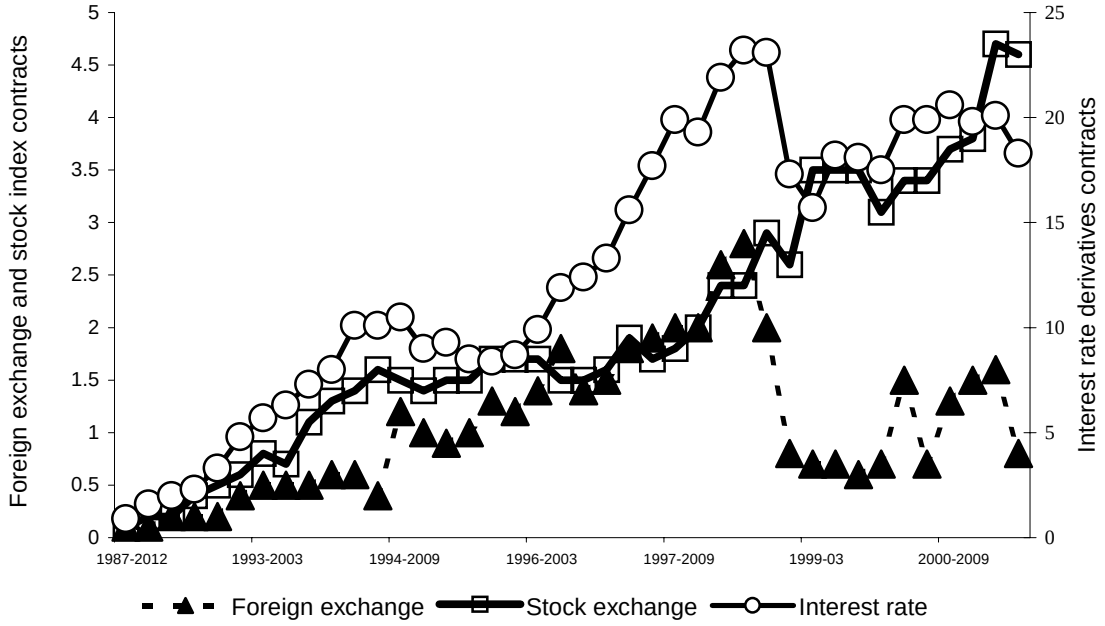
a/ Insurance companies, investment firms, pension funds and other forms of institutional saving. Netherlands 2000: insurance companies include life insurance only.

The expansion of secondary markets also aided financial deepening in developed countries (Fornari and Levy, 1999) and facilitated the emergence of new sources of corporate financing. One result of this was that the volume of bond issues in developed country markets, headed by the United States and Japan, more than doubled in the 1990s and also extended to a number of Latin American countries. The depth and liquidity of this well-developed secondary market, particularly in the United States, helped to finance the new high-technology sectors which led the economic expansion of the 1990s. Another recent innovation, the creation of risk capital funds, contributed to the growth of these activities, but this branch of activity appears to have come to an abrupt halt in the latest episode of economic turmoil.

Another result of the development of these markets is that the role of credit rating agencies has broadened considerably, as they provide information to investors and are consulted increasingly for regulatory purposes. A number of institutional investors, for example, will now accept nothing below an investiment-grade rating, and the Basel Committee recently put forward a proposal to use agency ratings in the regulation of the banking sector. There has been widespread criticism of the procyclical behaviour of agency ratings, in particular its impact on financing for developing countries (Reisen, 2001a and 2001b).

Lastly, the rapid growth of financial holdings by institutional investors effectively swelled demand for tools of risk diversification. Hence the development of specialized markets for particular instruments, such as the securitization of assets (including mortgage-backed assets), “junk bonds”, bonds issued by emerging economies and the securitization of assets based on shares in foreign firms, such as ADRs and GDRs. This phenomenon, in combination with the privatization of exchange risk, explains the demand for financial derivatives, which serve to hedge risk (see figure 2.7). The Asian crisis has severely affected the volume of exchange risk hedging contracts being concluded, however.

Figure 2.7
FINANCIAL DERIVATIVES TRADED ON ORGANIZED MARKETS
(*Millions of contracts*)



Source: Bank for International Settlements (BIS).

These trends have had both positive and negative effects on the industrialized economies. On the positive side, financing opportunities for production enterprises have expanded considerably, with both high-technology and medium-sized firms reaping the benefits. On the negative side, however, these trends have heightened financial fragility which, moreover, does not fall within the sphere of governance of the regulatory mechanisms of traditional banking activities. In fact, the activities that entail the highest risks and the greatest degrees of leverage —those associated with the derivatives market— remain outside the existing regulatory frameworks and there are as yet no proposals to extend regulatory standards to this domain. The regulations fall significantly short even with respect to institutional investors (D'Arista and Griffith-Jones, 2001).

There is, of course, nothing new in the volatile nature of financial markets, as economic history amply demonstrates (Kindleberger, Manias, Panics and Crashes) —even in recent times (BIS, 2001). This volatility was clearly reflected in the marked frequency of financial crises in both industrialized and developing countries in the last quarter of the twentieth century (IMF, 1998). Given that the majority of transactions on financial markets are conducted on an intertemporal basis, the lack of accurate information about the future constitutes the essential "market failure" to which its volatility may be attributed (Keynes, 1945; Eatwell and Taylor, 2000). Markets are thus vulnerable to changes of opinion and expectations that shift continually between optimism and pessimism as investors' "appetite for risk" varies. The impact of this is magnified by the effects of "contagion" of opinion and expectations from one market to another. These externalities constitute another basic market failure, since they can give rise to multiple equilibria and "self-fulfilling prophecies" when the expectations of a majority of agents point in the same direction.

Information asymmetries between debtors and creditors (Stiglitz, 1994) represent another market failure, as these translate into a bias in favour of debtors considered to be low-risk, and render markets strongly inclined to rely on the flawed information held by creditors on their

debtors, especially the highest-risk ones. Given that this market confidence also behaves in a procyclical manner, the spreads on the market's highest-risk loans are procyclical too, which generates alternate periods of "appetite" for high-risk activities and "flight to quality assets". This also accounts for the fact that secondary markets display much greater liquidity in times of abundance, as they too depend on the market's confidence in the information available to buyers. For this same reason, derivatives markets also tend to behave in a procyclical manner, with those operations that are considered to entail excessive risk even coming to a complete standstill in times of crisis.

Contemporary financial markets have a number of features that have tended to exacerbate their volatility.[27] These are: (i) inadequate regulation of the activities of both the banking sector and institutional investors and agents in the derivatives market, in addition to the procyclical bias of the existing regulations;[28] (ii) problems of contagion which arise when institutional investors face liquidity constraints in several markets simultaneously: when the price of a particular instrument falls, they are obliged to sell other types of holdings —even instruments that bear no relation to the original— in order to restore their own liquidity; this creates even more pressure when funds are withdrawn from a market that generally operates on the basis of spot transactions, or when these investors are under an obligation to meet certain commitments, including counterpart requirements on derivatives transactions, and, obviously, the larger the stake of high-leverage institutions in the market, the greater the pressure; (iii) the tendency for several agents to employ the same risk assessment systems, which heightens the correlation between the financial behaviour of —sometimes unlike— instruments and exacerbates the effects of contagion; (iv) the tendency to evaluate the performance of institutional investors over short periods of time, which has a similar effect; and (v) the procyclical behaviour of credit-rating agencies.

Figure 2.8 shows the correlation between two risk markets during the episode of turbulence that began with the crisis of 1997: the bond market in emerging economies and high-risk bonds in the United States. In both markets spreads first decreased, then entered a period of violent turbulence, in response first to the Asian and later to the Russian episodes; the Russian crisis had a much stronger impact and the spreads failed to recover a completely normal trend afterwards. Throughout this phase, the fluctuations were much sharper in emerging bond markets. By contrast, in the more recent crisis, which spread out from a United States epicentre, exactly the opposite occurred. In the period as a whole, there is a strong, positive correlation between the two markets.[29] The changing nature of contagion is illustrated in figure 2.8b, which shows the increase in spreads in the main Latin American economies during the five most recent crisis periods. All the countries exhibited a similar upward trend at these times, but the impact was much more powerful during the Asian and especially the Russian crises than during episodes centred in Latin American countries. This suggests that crises in developed countries have a much larger impact, especially when they affect agents with a high degree of leverage, some of which have withdrawn from emerging markets in recent years.

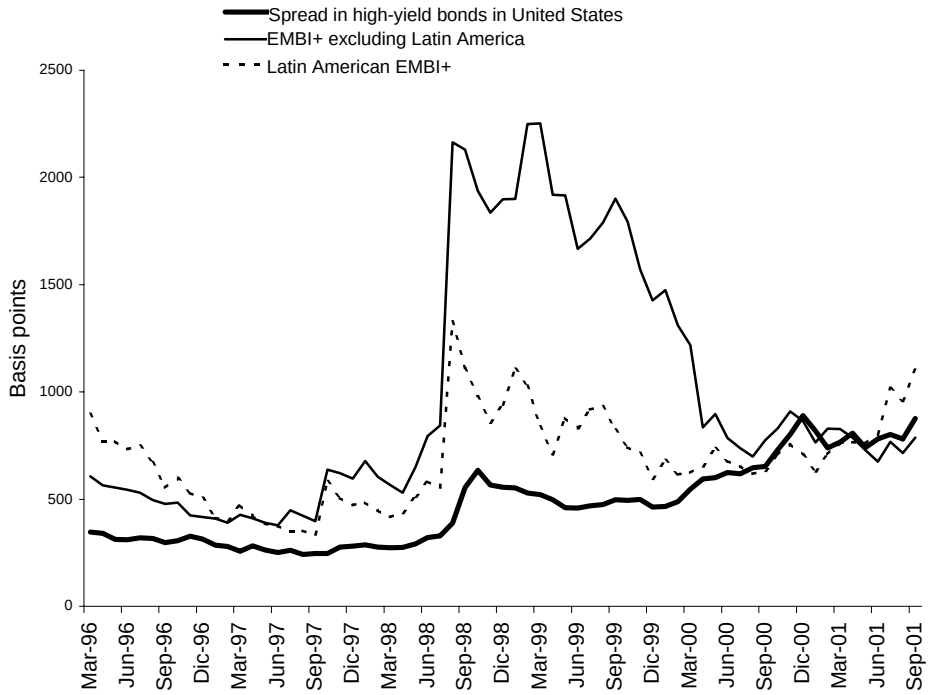
[27] An extensive range of literature has been produced on this subject. Among many other contributions, see Calvo and others (2001), Dodd (2001) and Persaud (2000).

[28] In the case of banking regulation, the rules on capital and loan loss reserves have this effect. In boom periods, increased earnings enable credit expansion, which is further facilitated by the fact that debtors tend to meet their commitments in a timely fashion, which enables reserves to be reduced. During bust periods, however, non-compliance with obligations increases, which means that the reserve position reduces banks' profits and therefore their credit capacity. A number of proposals have been put forward to mitigate this procyclical phenomenon (Ocampo, 1999a and 2002b).

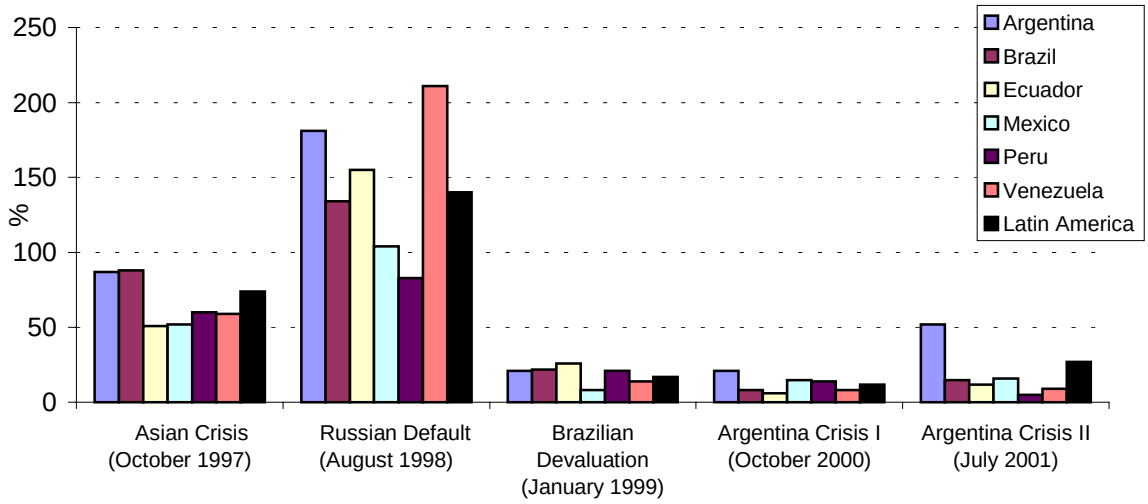
[29] The correlation of monthly spreads of Latin American instruments and high-risk instruments in the United States market was 0.56 in the period from March 1996 to September 2001, but rose to 0.79 between September 1997 and November 1999.

Figure 2.8
SPREADS IN EMERGING MARKETS

A. Merril Lynch High-Yield Master Index and J.P. Morgan EMBI+



B. Increase in bonds spreads (percentages)



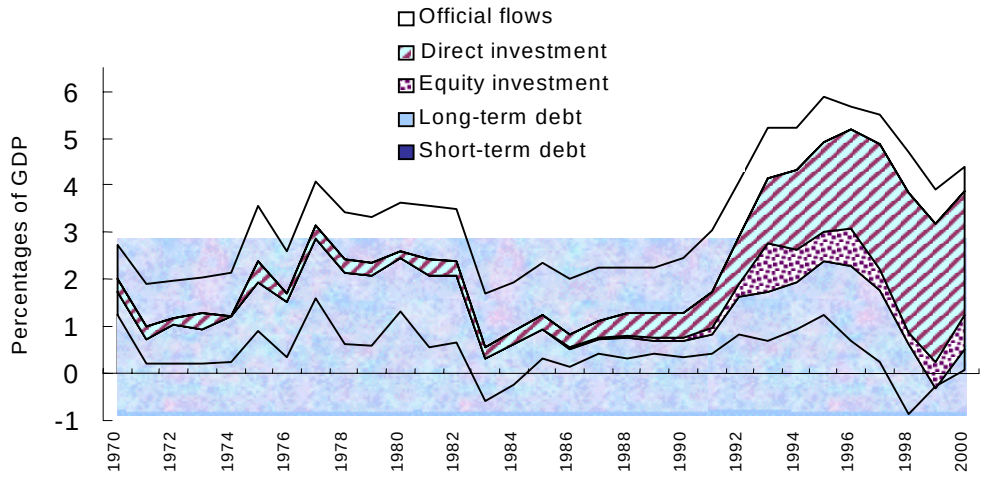
Source: ECLAC, on the basis of data from Merril Lynch and J.P. Morgan Chase.

State interventions to correct these market failures are always flawed and can easily translate into "government failures". Regulation is, a priori, the most important line of action, since it focuses on measures to prevent agents from undertaking undue risk in the first place. The development of regulation tends to lag behind the evolution of markets, however, and can itself generate mechanisms of evasion and avoidance which translate into weaker risk supervision (transactions conducted off the balance sheet, for example) or even suboptimal mechanisms of intermediation. Oversight is also essentially preventive, but is hindered by problems related to the flow of information, and its discretionary nature can lead to abuses. Interventions in response to systemic crises offer incentives to agents who are willing to take on undue risk, which can lead to problems of moral hazard. Lastly, interventions intended to compensate for a market bias towards more risk-oriented investors can create problems similar to moral hazard, including the affording of guarantees to high-risk debtors. Resolution of the problem by means of official financing can generate dependence on the State ("graduation" problems) and can even oblige private creditors to undertake higher risks, owing to the "preferred creditor" status of the official agency. For this reason, it is possible to compensate only partially for volatility and risk discrimination and this can only be achieved by means of an appropriate combination of instruments.

3. Capital flows to developing countries

Over the past three decades, developments in international markets, as described in the preceding section, have been reflected by fundamental changes in capital flows to developing countries.[30] The first notable change is the contrast between the slow growth of official financing flows and the increase in private flows, which are also highly volatile. As shown in figure 2.9, official financing tended to decline as a proportion of developing-country GDP, especially in the 1990s. This is primarily due to the slow growth of its main component: bilateral assistance funds, which declined in real terms over most of the decade. As a proportion of developed-country GDP, bilateral assistance fell from 0.35% in the mid-1990s to an average of 0.22% in the period 1998-2000. The decrease in bilateral assistance has been most pronounced in the case of the largest

Figure 2.9
NET FLOWS TO DEVELOPING COUNTRIES



Source: ECLAC, on the basis of World Bank, *Global Development Finance*, 2001, Washington, D.C., CD-ROM version, 2001.

[30] See UNCTAD (1999a), chapters III and V, and World Bank (1999a), which provide a detailed analysis of these trends.

developed countries, though it has been offset in part by the rising proportion of grants in comparison to concessional credits. Moreover, unlike private flows, official financing has not been pro-cyclical and, indeed, some components of it, particularly balance-of-payments support and multilateral development finance, have displayed countercyclical behaviour.

Private external financing has fluctuated widely owing to the effects of its most volatile components: short-term flows and long-term financing (which, in the figure, includes portfolio flows). During the most critical years, including both the debt crisis of the 1980s and the period after 1997, short-term flows were occasionally negative. Together, these two sources of funding increased from 1.0% of developing-country GDP for the period 1971-1974 to 2.3% for 1977-1982, fell to 0.5% for 1983-1990, peaked at 2.8% for 1993-1997 and dropped again to 0.7% for 1998-2000. A recovery began in 2000, but was interrupted in 2001. Foreign direct investment has remained largely independent of this cycle and has tended instead to follow long-term trends: an increase in the 1980s and a significant upsurge in the 1990s. While it was not affected by the series of crises that began in 1997, it was affected by the 2001 crisis.

This cycle reflects only part of the instability that has characterized private financial markets. Since the time of the Asian crisis, turbulence in these markets has taken various forms over shorter amounts of time: periodic interruptions, of variable duration, in market access, simultaneous increases in risk spreads and shorter maturities (see, in this regard, the preceding section and chapter 5).[31] In any event, it must be borne in mind that these short-term phenomena are compounded by the effects of contagion, which manifest themselves over the medium term and affect access to financing for relatively long periods. In both cases, the essential characteristic of contagion is that it tends to have similar effects on countries with either sound or unsound economic foundations, but which the market classifies in the same risk category. A striking example of this is Colombia's limited access to private banks during the debt crisis, despite its low levels of indebtedness. This is inconsistent with a risk assessment scale in which the variables are access to financing, the terms on which financing is provided or both.

The changes in the composition of financing over the past three decades are detailed in table 2.10. The upsurge in the financing received by Latin America and the Caribbean in the 1970s and its subsequent contraction, which affected only that region, were based primarily on bank financing, both long- and short-term. The type of bank financing that was characteristic of the 1970s (long-term syndicated credits) was not duplicated in the 1990s, when short-term financing took on much greater importance. Undoubtedly, the Basel standards played a major role, since they resulted in a preference for the granting of short-term, low-risk credits. In the 1990s, the Asia-Pacific region was the epicentre of the boom in short-term bank credit and of its subsequent contraction, which was much more severe and widespread in the developing world than the Latin American and Caribbean debt crisis. Reflecting the trend towards banking disintermediation and institutionalization of savings, the upturn in the period 1990-1997 was particularly evident in the bond market and in portfolio equity flows. Their performance during the financing crunch of 1998-1999 varied widely from one region to another, in relation to the averages for 1990-1997: the bond market became negative in Asia-Pacific but rose in Latin America and the Caribbean and in Central Europe, while the opposite occurred in the case of portfolio equity flows. Foreign direct investment has tended to increase in all regions, even during slumps in financial markets.

[31] See the International Monetary Fund's periodic reports on emerging markets and ECLAC (2001b, chap. 1), which contain detailed analyses of these trends.

Table 2.10
NET RESOURCE FLOWS: 1973-1999
(*Annual averages; billions of dollars*)

	Developing countries	East Asia and the Pacific	Europe and Central Asia	Latin America and the Caribbean	Middle East and North Africa	South Asia	Sub-Saharan Africa
1973-1981							
Total	**71.3**	**11.1**	**5.3**	**31.8**	**10.4**	**4.1**	**8.6**
Official flows	21.8	3.2	1.3	3.3	5.9	3.5	4.5
Direct investment	5.6	1.1	0.1	3.9	-0.4	0.1	0.8
Equity investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt flows	44.0	6.8	4.0	24.6	4.8	0.5	3.3
Bonds	1.2	0.2	0.0	1.0	0.1	0.0	0.0
Commercial banks	21.7	2.9	2.2	14.1	1.0	0.2	1.3
Short-term	16.5	2.8	1.5	8.6	2.3	0.3	1.1
Other	4.5	0.9	0.3	0.8	1.5	0.0	0.9
1982-1989							
Total	**81.0**	**17.6**	**8.8**	**15.0**	**14.1**	**10.1**	**15.3**
Official flows	38.3	5.9	1.4	6.8	6.9	6.1	11.0
Direct investment	13.0	4.5	0.2	5.4	1.4	0.3	1.2
Equity investment	0.8	0.5	0.0	0.1	0.0	0.1	0.0
Debt flows	29.0	6.7	7.1	2.7	5.7	3.7	3.1
Bonds	2.3	1.3	1.1	-0.6	0.2	0.3	0.0
Comercial banks	12.6	2.5	2.3	4.5	1.4	1.9	0.0
Short-term	6.8	1.9	2.5	-2.7	2.4	1.0	1.6
Other	7.3	0.9	1.2	1.5	1.8	0.5	1.5
1990-1997							
Total	**252.0**	**100.5**	**33.3**	**74.4**	**10.7**	**11.5**	**21.5**
Official flows	49.7	9.9	10.5	4.2	4.8	5.8	14.5
Direct investment	84.3	39.1	9.9	27.1	2.8	2.0	3.5
Equity investment	28.4	11.0	2.4	11.0	0.5	2.3	1.2
Debt flows	89.6	40.5	10.5	32.3	2.5	1.4	2.3
Bonds	30.0	12.2	4.0	12.4	0.3	0.6	0.6
Commercial banks	18.2	6.8	1.5	9.6	0.0	0.9	-0.7
Short-term	35.8	18.3	1.9	11.4	2.3	-0.3	2.2
Other	5.5	3.1	3.2	-1.1	-0.1	0.3	0.2
1998-1999							
Total	**264.8**	**49.8**	**60.0**	**118.4**	**7.5**	**2.4**	**19.8**
Official flows	49.8	14.9	8.2	8.8	1.9	5.0	10.9
Direct investment	181.1	59.7	25.8	81.2	4.0	3.3	7.1
Equity investment	25.0	15.1	3.2	2.8	0.8	0.8	2.3
Debt flows	8.9	-39.9	22.7	25.6	0.9	-6.8	-0.6
Bonds	12.7	-18.2	12.1	18.9	1.1	0.0	-1.1
Commercial banks	33.2	1.5	10.6	18.7	0.8	1.5	0.2
Short-term	-34.7	-24.1	1.1	-11.1	-1.0	-0.5	0.9
Other	-2.2	0.9	-1.0	-0.8	-0.1	-7.7	-0.5

Source: World Bank, *Global Development Finance, 2001*, Washington, D.C., CD-ROM version.

The upsurge in private financing in the 1990s occurred in response not only to changes in financial intermediation, but also to interest rate policy in the United States. Low rates exerted a decisive influence by steering institutional investors towards emerging-economy markets (Calvo and others, 1993; D'Arista and Griffith-Jones, 2001), while risk spreads were reduced in response

to the larger supply of resources, strengthening the effects of low rates with regard to financing terms. It may be observed that interest rates in the United States and risk spreads in emerging markets developed in a diametrically opposed manner in the period of turbulence that began in 1997, demonstrating that varying perceptions of risk in emerging markets have predominated in the determination of those spreads and of capital flows (see box 2.2). What is more, United States interest rates, in more than a few cases, have responded endogenously to varying perceptions of risk, either because the "flight to quality assets" has raised public debt bond prices, thereby reducing their returns, or because the authorities have responded to market uncertainty by lowering interest rates.

Box 2.2
INTEREST RATES AND EMERGING MARKET BOND SPREADS

One of the key external variables that influence emerging market interest rate spreads are changes in United States interest rates (Calvo and others, 1993; Fernández-Arias, 1996; IMF, 2001a; and Calvo and others, 2001). Conceptually, a rise in United States interest rates is expected to lead, all else equal, to an increase in debt service payments for emerging market borrowers, increasing the likelihood of default and the corresponding risk premium incorporated into bond spreads. Higher United States interest rates could also reduce investors' appetite for risk, reducing their exposure in risky markets and the availability of financial resources in borrowing countries as a result (Kamin and Kleist (1999)). Similarly, a fall in United States interest rates is expected to lead to a decrease in emerging market spreads through its impact on the ability of debtor countries to repay loans. Lower United States interest rates would also be associated with lower emerging market spreads because investors, seeking to enhance the overall return on their portfolios, would switch to emerging market debt whenever yields in mature markets fall.

Evidence for the early 1990s indicates that, prior to the Mexican financial crisis of December 1994, spreads in emerging markets and United States interest rates moved together, confirming these theoretical presumptions. However, in the second half of the 1990s, the behaviour of emerging market bond spreads, new debt issuance and maturity would suggest that other factors were more predominant in the determination of spreads and capital flows than changes in U.S. interest rates.

The empirical evidence of the second half of the 1990s reveals that changes in emerging market bond spreads and United States interest rates moved in opposite directions. From March 1996 to September 2001 there was a significant negative correlation of -0.6 between the 10-year United States Treasury bond yield and the Emerging Markets Bond Index Plus (EMBI+) and the Latin EMBI+ spreads; the correlation between emerging market bond spreads and the United States federal funds target rate over the same period was also negative, albeit less strong (-0.3 for the EMBI+ and -0.4 for its Latin component).

The novel feature of this period is the strength of financial contagion, which led to a widespread increase in emerging market bond spreads during the episodes of market turbulence in the second half of the 1990s, particularly the Asian and Russian crises. Movements in United States corporate high-yield bond spreads were also strongly and positively associated with movements in emerging markets bond spreads.

Moreover, debt flows to Latin America responded more to movements in spreads than to United States interest rates during the period under analysis. Other things being equal, increases in United States interest rates are expected to be associated with capital outflows from emerging markets and declines in United States interest rates, with capital inflows. However, when periods of easing and tightening of United States monetary policy are isolated, the correlation between debt flows to Latin America and United States interest rates does not show the expected negative sign. These flows, including debt securities issued abroad and Brady bonds, showed a positive correlation of 0.6 with the 10-year United States Treasury bond yields. The correlation was particularly strong in the period of the Asian, Russian and Brazilian crises.

In the 1990s, private flows were concentrated in middle-income countries (see table 2.11). Conversely, the share of low-income countries in private financing has been lower than their share in the total population of developing countries, as might be expected, but also lower than their contribution to the developing countries' GDP. This fact is particularly striking in bond financing, commercial banking and portfolio flows, if India is excluded in the latter case. In all these cases, private financing directed to poor countries is minimal. The share of low-income countries in FDI is also smaller than their contribution to the developing countries' GDP. For these reasons, the volatility of capital flows and issues of contagion have become particularly relevant to middle-income developing countries.

Accordingly, low-income countries have continued to depend on dwindling official sources of funds. These countries rely heavily on official development assistance, particularly grants, coming mostly in the form of bilateral aid. This is the only component of net resource flows to developing countries, again with the exception of India, that is distributed in a progressive manner. Multilateral financing has followed the same pattern, except in the case of IMF resources.

The volatility of private financial flows and their considerable concentration in middle-income countries have created large-scale needs for exceptional financing, which have been concentrated in a few emerging economies. As a result, IMF financing has exhibited strong countercyclical behaviour and has been concentrated in a small number of countries; this could have systemic effects. However, it should be stressed that exceptional financing has been lower than it was in the 1980s in relation both to the value of the recipient countries' international reserves and to the value of their exports, and, with respect to the former, also lower than it was in the 1960s (see figure 2.6). This is a clear sign that the level of IMF exceptional financing has tended to lag behind the level of international economic transactions. Obviously, the comparison is still less favourable if the capital account shocks faced by the developing countries are taken as a benchmark, even though, in the view of the Chairman of the United States Federal Reserve Board, "the size of the breakdowns and required official finance to counter them is of a different order of magnitude than in the past" (Greenspan, 1998).

As shown in figure 2.10, the countercyclical behaviour of financing and its concentration in a few countries are closely related. The proportion of IMF financing directed to large borrowers[32] has displayed a strong upward trend over the past two decades. Indeed, IMF financing data underestimate the provision of emergency funds to large borrowers, as they do not include bilateral contributions to the largest bailouts of recent years (Indonesia, the Republic of Korea, Thailand, the Russian Federation, Brazil, Mexico and the "financial armour" provided to Argentina in 2000).[33] These programmes have been severely criticized in developed countries as creating "moral hazard", and this has translated into a less favourable attitude towards exceptional financing. On the other hand, processes aimed specifically at external debt renegotiation have been supported, despite the lack of appropriate international institutions to address this problem.

[32] This group consists of Argentina, Brazil, China, India, Indonesia, Mexico, the Republic of Korea and the Russian Federation.
[33] However, pledged bilateral financing tends to be disbursed in smaller proportions than the multilateral shares in bailout packages.

Table 2.11
NET RESOURCE FLOWS, 1990-1999
(*Annual averages; billions of dollars and percentages*)

	Direct investment		Equity investment		Grants		Bilateral financing		Multilateral financing (excluding IMF)		Bonds	
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage
Developing countries	**103.7**	**100.0**	**27.7**	**100.0**	**29.8**	**100.0**	**4.1**	**100.0**	**15.8**	**100.0**	**30.6**	**100.0**
Excluding China	75.4	72.7	24.8	89.4	29.5	99.0	2.6	62.4	13.9	88.0	29.4	96.0
Low-income countries	*10.2*	9.8	*3.9*	14.0	*15.2*	51.0	*2.5*	59.9	*6.7*	42.4	*1.7*	5.6
India	1.5	1.4	1.7	6.0	0.5	1.8	0.0	0.3	1.1	7.2	0.7	2.2
Other countries	8.7	8.4	2.2	8.0	14.7	49.2	2.5	59.6	5.6	35.2	1.0	3.4
China a/	*28.3*	27.3	*2.9*	10.6	*0.3*	1.0	*1.6*	37.6	*1.9*	12.0	*1.2*	4.0
Middle-income countries	*65.2*	62.8	*20.7*	74.6	*14.3*	48.0	*0.1*	2.5	*7.2*	45.6	*27.7*	90.4
Argentina	6.6	6.4	1.1	4.1	0.0	0.1	-0.2	-5.6	1.1	6.9	4.9	15.9
Brazil	10.9	10.5	2.8	10.1	0.1	0.2	-0.8	-20.4	0.6	4.0	2.6	8.5
Mexico	8.2	7.9	3.8	13.5	0.0	0.1	-0.4	-9.7	0.5	3.3	4.2	13.7
Indonesia	2.1	2.0	1.6	5.9	0.3	0.9	1.3	32.1	0.6	3.8	0.9	2.8
República of Korea b/	2.6	2.5	3.7	13.5	0.0	0.0	0.4	9.2	0.8	5.1	4.9	15.9
Russian Federation	1.8	1.7	0.8	2.7	0.8	2.7	1.1	27.0	0.7	4.3	1.6	5.4
Other countries	33.1	31.9	6.9	24.8	13.1	44.0	-1.2	-30.1	2.9	18.1	8.6	28.2

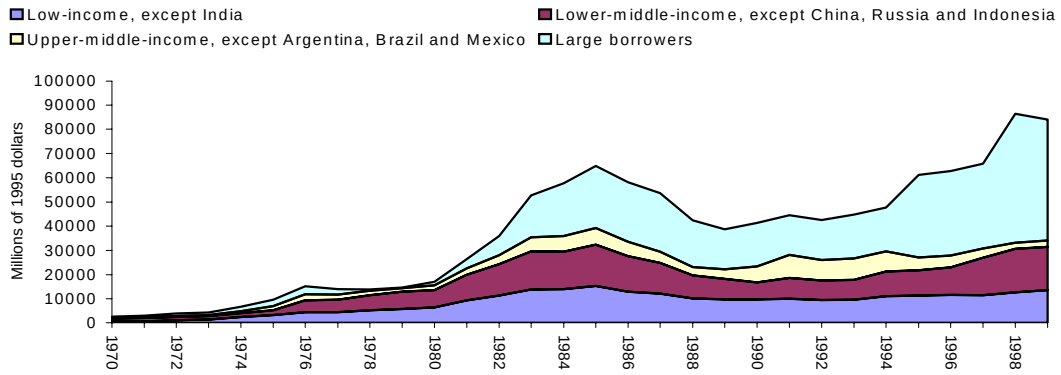
	Commercial bank credits		Other credits		Long-term flows		Short-term debt flows		Total net flows		Memo GDP	Memo Population
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage
Developing countries	**17.1**	**100.0**	**4.0**	**100.0**	**232.8**	**100.0**	**22.5**	**100.0**	**255.4**	**100.0**	**100.0**	**100.0**
Excluding China	16.6	97.1	1.1	26.6	193.2	83.0	21.7	96.2	214.9	84.2	88.2	74.8
Low-income countries	*0.8*	4.5	*0.4*	9.1	*41.3*	17.7	0.7	2.9	42.0	16.4	*17.0*	*46.7*
India	0.5	2.9	0.1	2.0	6.1	2.6	-0.4	-1.7	5.7	2.2	6.3	19.4
Other countries	0.3	1.6	0.3	7.1	35.2	15.1	15.1	67.1	50.3	19.7	10.8	27.3
China a/	*0.5*	2.9	*2.9*	73.4	*39.6*	17.0	0.9	3.8	40.5	15.8	*11.8*	*25.2*
Middle-income countries	*15.9*	92.5	*0.7*	17.6	*151.7*	65.1	21.0	93.3	172.7	67.6	*71.1*	*28.1*
Argentina	0.6	3.7	-0.1	-1.3	14.1	6.0	3.4	15.1	17.5	6.8	*4.5*	*0.7*
Brazil	5.2	30.2	-0.4	-9.3	20.9	9.0	1.0	4.5	21.9	8.6	*11.0*	*3.3*
Mexico	2.6	15.0	-0.3	-6.5	18.6	8.0	0.3	1.2	18.9	7.4	*6.7*	*1.9*
Indonesia	0.2	1.0	-0.1	-1.3	6.9	3.0	0.9	4.0	7.8	3.0	*2.9*	*4.1*
República of Korea b/	-0.9	-5.5	-0.1	-3.6	11.3	4.9	5.9	26.4	17.2	6.8	*7.0*	*0.9*
Russian Federation	0.2	1.1	2.0	51.1	9.0	3.9	-0.8	-3.4	8.2	3.2	*7.6*	*3.1*
Other countries	8.1	47.1	-0.5	-11.6	70.9	30.5	10.2	45.4	81.1	31.8	31.4	14.0

Source: World Bank, *Global Development Finance, 2001*, Washington, D.C., CD-ROM version and *World Development Indicators 2001*, Washington, D.C., CD-ROM version (for GDP and population data).

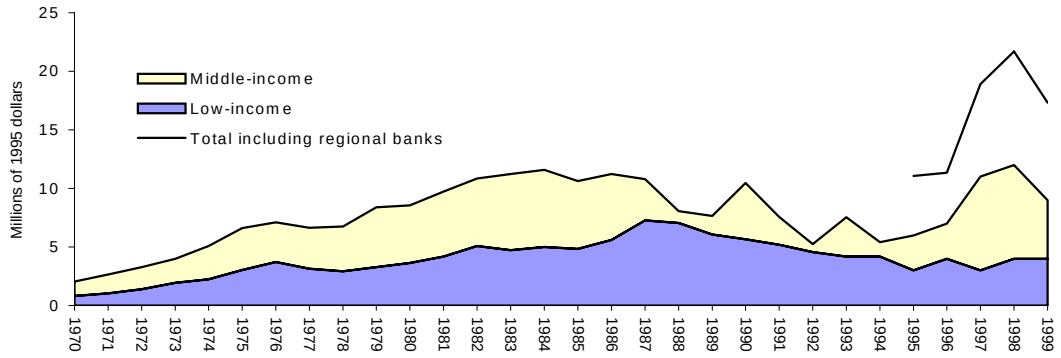
a/ The World Bank considers China a middle-income country; in this table, it is presented in a separate category.
b/ The World Bank considers the Republic of Korea a high-income country; however, Global Development Finance 2001 includes it in the middleincome group.

Figure 2.10
CREDITS OF INTERNATIONAL FINANCIAL INSTITUTIONS

A. International Monetary Fund credits



B. Development bank credits



Source: ECLAC, on the basis of International Monetary Fund (IMF), *International Financial Statistics, 2001*, Washington, D.C., CD-ROM version, December 2001 and World Bank, *Global Development Finance, 2001*, Washington, D.C., CD-ROM version, 2001.

As shown in figure 2.10, World Bank financing and development-bank financing in general for middle-income countries has displayed a similar countercyclical pattern. Such financing complements that of IMF, since it provides governments with long-term resources. In view of the volatility of private financing, these resources are usually the primary, and sometimes the only, source of long-term financing available in times of crisis.

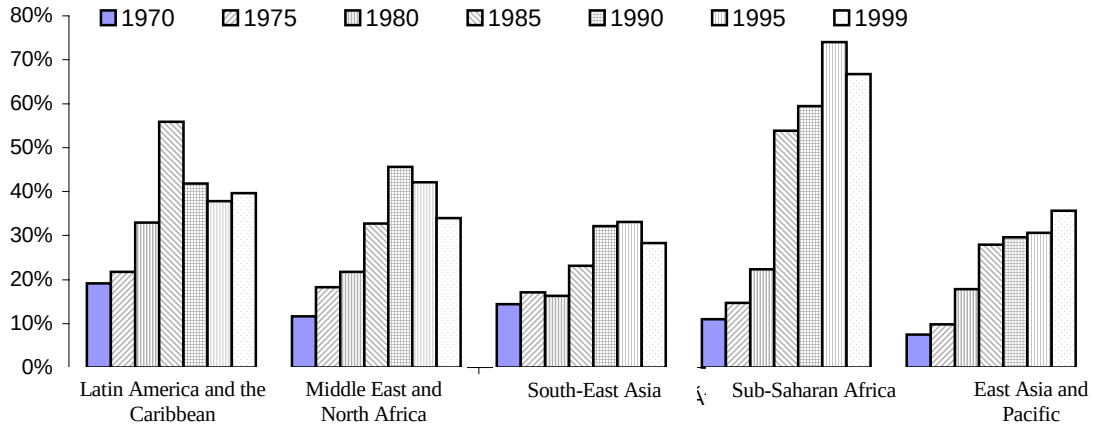
The tendency to direct loans to middle-income countries has not completely crowded out low-income countries. Indeed, the flow of IMF resources to the latter has been fairly stable, and has even increased when they have required additional balance-of-payments support. This occurred in Latin America and the Caribbean in the 1980s and in Asia-Pacific during the Asian crisis. The flow of World Bank resources to low-income countries has followed an upward trend in recent decades.

Overall external indebtedness trends among developing countries have not been positive, although the patterns vary considerably from one region to another. Compared to their levels in 1980, prior to the Latin American debt crisis, the external debt/GDP ratios for all parts of the developing world have risen, but those for certain developing regions (including Latin America and the Caribbean) have fallen in relation to the critical levels reached in the mid- or late 1980s (see figure 2.11.a). In contrast, external debt/exports ratios have developed more favourably (see figure

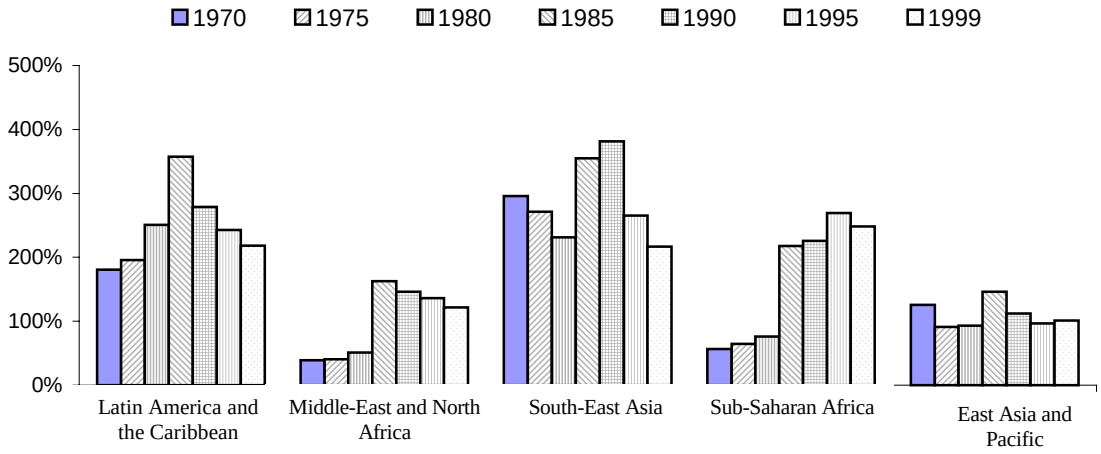
2.11.b). The problem appears more serious when the debt ratios of certain countries are compared to benchmarks indicating what are deemed to be manageable levels. On the basis of World Bank data on 84 developing countries for which information is available for the period 1980-2000, it can be determined that the number of countries with external debt/GDP ratios of less than 40% has fallen from 45 to 23 and that the number with external debt/exports ratios of less than 200% has fallen from 56 to 33.

Figure 2.11
EXTERNAL DEBT

A. Percentage of GDP



B. Percentage of exports



Source: World Bank, *Global Development Finance, 2001*, Washington, D.C., CD-ROM version, 2001.

Nonetheless, the risk of a sudden change in interest rates, such as the one that occurred in the early 1980s, has decreased as a result of the control of inflation in developed countries. In any event, it should be recalled that real interest rates in those countries remained high in the last two decades of the twentieth century (though they declined during the recent crisis) and, particularly, that the margins applicable to developing countries in private capital markets are usually very high. In terms of the traditional criteria of sustainability of debt ratios, calculated by comparing economic growth to real interest rates, the ratio continues to be unfavourable in most countries.

Lastly, the banking system's tendency towards concentration at the international level has spread to developing countries. This process reflects both the expansion of large international banks and the strategy adopted by smaller ones to deal with international competition, as in the case of Spanish banks in Latin America. However, the degree to which banking is concentrated in the hands of foreigners varies widely from one region to another and from one country to another within the same region. Central Europe and Latin America show much higher levels of concentration than the countries of Asia-Pacific (52%, 25% and 6%, respectively, of total bank assets in 1999). The share of foreign banks ranges from a maximum of between 42% and 54% in Argentina, Chile and Venezuela to a minimum of around 18% in Brazil, Mexico and Colombia. This process has been encouraged by the regulatory authorities of developed countries as a means of reducing the banks' exchange rate risks (Hawkins, 2001). The annex on financial services to the WTO General Agreement on Trade in Services constitutes an international institutional framework that provides legal guarantees for this process.

The combination of financial liberalization, penetration by foreign banks and new private-sector external linkage arrangements has given rise to a profound restructuring of the developing countries' financial systems. In many ways, national financial sectors are now more diversified in terms of services, but some of their traditional shortcomings persist. The bias towards short-term operations and high intermediation margins is still the norm, as is credit rationing, especially for small and medium-sized enterprises and low-income families. While local stock markets have expanded in some countries, primary share issues have not increased, as large firms have preferred to issue them in international financial centres. Lastly, despite the major changes introduced in the area of banking regulation and supervision, the stability of local markets has shown no significant improvement, as witnessed by the numerous and recurrent crises they have suffered.

III. International migration

In the first phase of globalization, from the last quarter of the nineteenth century to the early twentieth century, the expansion of trade and high capital mobility were accompanied by an increase in migratory flows, with the result that this period is also known as the "era of mass migration" (Castles and Miller, 1993; Hatton and Williamson, 1998). This wave of migration was directed towards a number of countries in the New World (the United States, Canada, Argentina, Brazil and Australia). Between 1870 and 1920, the United States, which was the chief recipient of these migrants, took in more than 26 million people, primarily from Europe, who came to represent more than 10% of the country's total population (Solimano, 2001).

Some of these migratory flows helped to create an interregional and intraregional economic convergence (European emigration to the New World and to other European countries, respectively), while others accentuated the inequality of the international economic order, as in the case of the Chinese coolies and the Indians transported to tropical plantations. From the outset, two disparate trends prompted by these migratory flows began to emerge: the trend towards the homogenization of wages at high levels in the developed world and the trend towards the convergence of low wages in the developing world.

During that period, the countries of the New World adopted liberal immigration policies, and, in a number of cases, governments used various means to encourage foreigners to take up residence, in response to the need to increase the labour force and to populate their territories at a time of strong economic expansion. Only in the early twentieth century did they begin to apply somewhat more restrictive policies, accompanied, in some countries (Australia, Canada and the United States), by measures that discriminated against Asian immigrants, especially those from China.

The phenomenon of migration gathered new momentum after more than half a century, as part of the third phase of globalization in the last quarter of the twentieth century. In that period, migration to nearly all the countries of the Organization for Economic Cooperation and Development (OECD) increased in comparison to previous decades, although its magnitude was much less than that of late nineteenth-century migration.[34] In some recipient countries, this process reached its peak in the early 1990s (United States, Germany, Japan and Canada), while in others (United Kingdom and Australia) it had reached this point some years earlier. Since that time, largely as a result of the widespread imposition of legal limits on immigration, migratory flows have declined significantly (see table 2.12).

Major changes can also be observed with respect to the regions and countries of origin of immigrants (see table 2.13). Immigration to the United States in the third phase of globalization has consisted primarily of Latin Americans and Caribbeans (46%) and Asians (34%), in sharp contrast to the trend of the nineteenth century, when nearly 90% of the immigrants to the United States came from Europe (Solimano, 2001). In the European Union, internal migration predominates, representing two thirds of the total (66.2%); other major regions of origin are Africa (16.2%) and Asia (10.6%) (Salt, 1999). Almost three fourths of Japan's immigrants come from Asia (53.3%), Latin America and the Caribbean (10.2%) and the United States (8.8%).[35]

Table 2.12
ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT: THE 10 MAIN COUNTRIES OF DESTINATION OF IMMIGRANTS
(Thousands of persons)

Recipient country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Average
United States a/	1 537	1 827	974	904	804	721	916	798	661	647	979
Germany b/	842	921	1 208	987	774	788	708	615	60	674	812
Japan b/	224	258	267	235	238	210	225	275	26	282	265
United Kingdom a/	…	…	204	190	194	206	216	237	258	277	223
Canada a/	214	231	253	256	224	213	226	216	174	190	220
Italy a/	…	…	…	…	…	…	…	…	111	268	190
France a/	102	11	117	99	92	77	76	102	138	104	102
Australia a/	121	122	107	76	70	87	99	86	77	84	93
Switzerland b/	101	110	112	104	92	88	74	73	75	86	92
Netherlands b/	81	84	83	88	68	67	77	77	82	78	79

Source: Organisation for Economic Co-operation and Development (OECD), *Trends in International Migration. 2000 Edition*, Paris, 2000 and Continuous Reporting System on Migration (SOPEMI), *Annual Report, 2001*, Paris, 2001.

a/ Data based on residence permits or other sources.
b/ Data based on population records.

[34] In the case of the United States, the chief recipient country, immigration rose to nearly 7.5 million people in the last two decades of the twentieth century, compared to about 2.5 million in the 1950s and one million in the 1940s. However, as a proportion of the country's population, immigrants represented less than 3% in the last third of the twentieth century, which was much lower than the percentages recorded between 1870 and 1920 (over 10%).

[35] Salt, 1999, CDMG (99) 29E), 1999 and OECD, 2001a.

Table 2.13
ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT: NATIONS OF ORIGIN OF IMMIGRANTS TO THE MAIN RECIPIENT COUNTRIES, 1999
(Percentages)

Recipient	Primary countries of origin					
	First	**Second**	**Third**	**Fourth**	**Fifth**	**Cumulative**
United States	Mexico (19.9)	China (5.6)	India (5.5)	Philippines (5.2)	Dominican Rep. (3.1)	39.3
Germany	Yugoslavia (13.1)	Poland (10.7)	Turkey (7.0)	Italy (5.2)	Russia (4.1)	40.1
Japan	China (21.0)	Philippines (20.3)	Brazil (9.3)	United States (8.8)	Korea (8.2)	67.6
United Kingdom	United States (16.2)	Australia (12.1)	South Africa (8.7)	India (7.1)	New Zealand (5.7)	49.8
Canada	China (20.2)	India (9.2)	Pakistan (4.9)	Philippines (0.8)	Korea (3.8)	42.9
Italy	Albania (13.9)	Morocco (9.3)	Yugoslavia (9.1)	Romania (7.8)	China (4.1)	44.2
France	Morocco (13.5)	Algeria (10.9)	Turkey (5.5)	Tunisia (3.8)	United States (2.6)	36.3
Australia	New Zealand (22.2)	China (11.4)	United Kingdom (10.5)	South Africa (5.9)	India (3.1)	53.1
Switzerland	Yugoslavia (14.7)	Germany (12.8)	France (7.2)	Italy (7.0)	Portugal (5.8)	47.5
Netherlands	United Kingdom (6.4)	Germany (5.7)	Morocco (5.6)	Turkey (5.4)	United States (4.2)	27.3

Source: Organisation for Economic Co-operation and Development (OECD), *Trends in International Migration. 2000 Edition*, Paris, 2000 and Continuous Reporting System on Migration (SOPEMI), *Annual Report, 2001*, Statistical Annex, Paris, 2001.

The composition of these flows reflects the influence of factors such as distance, language, historical relations and cultural affinity on the decision to emigrate. More than half of Japan's immigrants come from China, the Republic of Korea and the Philippines, whereas nearly a quarter of the immigrants to the United States come from Mexico, the Dominican Republic and Canada. The countries of origin of migrants to the United Kingdom and France reflect strong historical and cultural ties.

These ongoing migratory movements have taken place in the context of significant changes in legislation, which, in general, have been much more restrictive than in the past and have been aimed at improving the control of illegal immigration. In the United States, such legislation has been changed several times since the 1960s. The 1965 reform of the Immigration and Naturalization Act established a system of preferences based on family relationships with United States citizens, encouraged the immigration of individuals with the skills and training in greatest demand in the labour market, set quotas by country of origin and introduced measures to eliminate ethnic discrimination. Further legislative changes were introduced in 1986 with the aim of controlling illegal immigration through increased vigilance at the country's borders and programmes to regularize the status of undocumented immigrants. Another reform was introduced in 1996 with a view to strengthening the control of illegal immigration.

Since the early 1990s, the immigration policies of the European countries have been set by the European Union. The main feature of this legislation is the clear distinction laid down in the

Treaty of Rome between immigrants of Community origin and those of non-Community origin. While the former enjoy fully the right to reside and work in any country of the Union, the latter are subject to strict limitations and are required to obtain a working visa before they can become residents. Australia, Canada and Japan have also adopted restrictive immigration policies in recent years, particularly with respect to the granting of permanent residence permits. To counterbalance this situation, special programmes have been implemented to facilitate temporary residence, usually through the issuance of work permits in specific areas, either to lend greater flexibility to the labour market or to address labour shortages in certain sectors (OECD, 2001a).

Thus, even though it has coincided with an increased tendency to reduce obstacles to capital mobility, the free movement of persons is limited to specific regions within the OECD countries and to the most highly skilled workers. However, the individuals most likely to emigrate are relatively low-skilled workers wishing to move from South to North. In addition, since the disappearance of the socialist world, a strong trend towards emigration, primarily to European Union countries, has been observed in the countries of Central and Eastern Europe and in those of the former Soviet Union. Consequently, tighter control over irregular migration and the employment of undocumented workers, along with limitations on the right to asylum on political and humanitarian grounds, have become the major issues to be addressed in the developed countries' immigration policies (OECD, 2001a).

In the 1990s, this relationship between the propensity to migrate and restrictions on the free movement of labour resulted in a considerable increase in irregular migration to OECD countries, which, by its very nature, is impossible to measure with complete accuracy. The persistence of irregular migration has prompted nearly all the OECD countries to tighten controls on the income, residence and employment of foreigners. At the same time, various programmes have been adopted to regularize the status of undocumented residents.

International migration has profound effects on the basic structures of the sending and receiving countries. It is widely acknowledged that inequalities in levels of development are the primary determinant of migration. Accordingly, if globalization results in the accentuation of these inequalities, the propensity to migrate will persist and could even increase. At the same time, the growing interdependence among nations has heightened the transnationalization of communities and has led to the diversification of mobility arrangements. Another factor that encourages migration is the wider dissemination of cultural models, patterns of behaviour and aspirations, since this makes potential migrants more aware of existing global inequalities in levels of development. Moreover, advances in communications and transport have reduced the direct costs of migration.

In contrast to past trends, migration today is not related to the occupation of unpopulated areas. Because it is directed primarily from South to North, the challenge of incorporating immigrants is faced by highly structured societies whose economic, social and demographic conditions differ considerably from those of the immigrants' countries of origin. The integration of immigrants into the recipient societies and the definition of their rights and demands for citizenship have become a major political issue. Institutional responses to this problem have varied, combining both humanitarian and restrictive attitudes, with the latter based on the defence of sovereignty. In the countries of origin, ties with emigrants have become especially important, since they represent not only a source of funds, but also the potential for change and innovation. These ties represent the reverse side of integration and, as shown by the emergence of immigrant communities and their social networks, one of the seeds of transnationalization.

It may be that the growing demand for foreign workers with specific skills, as reflected in the immigration policies of developed countries, is helping to perpetuate and widen the gaps that separate the industrialized countries from the developing world. While the developed countries' importation of human capital has serious consequences for the countries of origin (brain drain), the gradual formation of a global market in highly skilled human resources could mitigate those effects

by promoting the circulation and exchange of human resources and the transfer of scientific and technological know-how.

Organizations of immigrants in the main recipient countries, such as those which have emerged in the United States, provide frames of reference for strengthening collective identity, and facilitate the globalization of immigrants' cultural expressions and the spread of their products in the recipient societies. Such organizations help immigrants to maintain close ties with their places of origin; one of the most important of these ties is the sending of remittances. The use and origin of remittances, the channels through which they are mobilized and their real and potential effects on the development of the recipient communities have been only partially assessed, and few policies have thus far been introduced in this area.

Although the debate on migration, its causes and its consequences has awakened greater interest today than ever before, the controversial nature of these issues makes it difficult to adopt global agreements and specific courses of action on the subject. In recent years, it has become clear that international migration must be understood as a phenomenon requiring the adoption of multilateral measures based on cooperation among States. It is also clear that governments and civil-society organizations in countries of origin, destination and transit share a concern for the human rights of migrants, in relation both to the decision to emigrate or stay in the country of origin and to the possibility of exercising citizenship in the countries of origin and destination. These convictions have been strengthened by the need to join forces to combat a crime which has grown to very serious proportions: trafficking in immigrants, which is a source of illicit profit for organizations that operate on an international scale.