2. Global Governance, Financial Architecture and Economic and Social Development

*Rong-I Wu*

Editor’s note: This paper is a revision of the opening lecture from the World Forum on Social Development’s special panel discussion on “The Asian Financial Crisis and Its Economic and Social Consequences”.

I. Recent Developments in Globalization

Globalization can hardly be described as a new phenomenon of the late twentieth century, nevertheless, in recent years it has invited enthusiastic discussion, particularly in the aftermath of the Asian financial crisis that first struck in Thailand in 1997, and the high profile demonstrations which took place in Seattle in 1999 – which provided a severe setback to the millennium round of WTO negotiations. According to the United Nations Conference on Trade and Development (UNCTAD), the principal forces driving globalization over recent decades include improvements in technology, the continuous opening up of markets to external trade, foreign direct investment (FDI), the flow of technology and the resulting competitive pressures. Thus, it has become commonplace to characterize

* President of the Taiwan Institute for Economic Research, Taipei, Taiwan. This lecture was delivered at the opening session of the World Forum on Social Development - Geneva 2000 Conference, June 22-30, 2000. E-mail: rongwu@tier.org.tw
the degree of globalization within an economy by the amount of FDI it attracts, and the volume of trade that a country is able to generate in proportion to its gross domestic product (GDP). The United Nations, for example, uses FDI and trade as measures of internationalization.

In order to gain a general understanding of the process of globalization over the past three decades, we should first of all examine FDI inflows and outflows as a proportion of GDP. From 1970 to 1972, the worldwide total of FDI inflows and outflows accounted for 0.3 percent of global GDP. During the period from 1980 to 1982, the rate went up to one percent, and expanded further to 2.2 percent of the world's total GDP between 1994 and 1996. In both 1997 and 1998, worldwide FDI inflows and outflows grew significantly. By 1998, the combined total was estimated to account for around 4.5 percent of the world's GDP.1

The process is more striking if we look at inward plus outward FDI stock as a proportion of the world’s GDP. In 1980, such investment was 9.5 percent of the global GDP. In 1990, it had increased to 15.8 percent and by 1998 it was 28.6 percent. World trade has seen even more rapid integration. From 1970 to 1972, exports and imports comprised only 8 percent of the world’s GDP. During the period from 1980 to 1982, worldwide imports and exports soared to 42.4 percent of the world’s GDP, although the 1994 to 1996 period saw a slight downturn in international trade to 41.2 percent.

There is no doubt that globalization has brought greater prosperity too much of the world. Much greater freedom of trade and more open trade has also enhanced consumer welfare whilst raised living standards in many developing countries. FDI is favorable insofar as it imports advanced management skills and technology whilst also creating jobs. And for a number of decades many of the developing countries have benefited from the globalization boom. At the same time, however, rapid globalization has widened the gap between the richer and poorer countries. As the world increasingly moves towards becoming a single marketplace, many commentators have voiced concerns over the spread of globalization. One particular point singled out for criticism is that globalization has further polarized world income distribution, arguably victimizing the poorer countries whilst providing the already developed economies with more

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1 In 1998, FDI inflows and outflows were US$644bn and US$649bn, respectively, whilst global GDP stood at US$28,767bn.
than their fair share. Indeed, globalization is not necessarily a benign phenomenon in its own right. Two obvious examples are the Asian financial crisis and the uproar that led to the paralysis of the WTO meeting in Seattle in 1999.

The Asian financial crisis brought down many of the Asian economies almost overnight. The major force behind the crisis was the instantaneous outflow of massive amounts of capital across national borders. Whilst some have argued that unsound economic fundamentals were to blame for the fall of some of these Asian economies, serious concerns have been raised as to how it is possible to fend off attacks from extremely well-financed speculators. The impacts of the crisis were much less severe for some of the Asian economies, partly as a result of their strong macroeconomic conditions and partly due to other institutional factors; but still, high prices were paid by all of the economies.

The 1990s have been an era of financial crises, stretching across the globe from the crisis in Mexico to the financial crisis in Asia, along with other crises in Latin America and Russia. The wealth of a developing economy is rarely sufficient to rival that of the already developed economies in terms of capital; thus, over recent decades, many of the developing nations around the world have come to rely heavily upon foreign capital for their rapid economic development. The Asian countries were no exception. Unfortunately, the hasty opening up of the capital accounts of the Asian countries resulted in their extreme over-reliance on such foreign capital. Thus, the evils of globalization will not go away unless the world comes up with an effective way to monitor and keep in check the international flow of capital.

The failure to start a new millennium round of negotiations at the third WTO ministerial meeting in Seattle in 1999 further demonstrated the downside to globalization. In their demands that labor standards and environmental protection must not be sacrificed in the name of trade, non-governmental organizations (NGOs), along with many other anti-globalization protestors, succeeded in pulling together people from all over the world to disrupt the proposed meeting.
II. Globalization and Country-Specific Performance

In the process of globalization there are bound to be winners and losers, and the economic performance under increased globalization varies from one country to another. A comparison, for example, of the GDP growth of countries in the Asia-Pacific region highlights the competitive nature of the globalization process. In the 1980s, the growth rate of the world economy averaged 3.2 percent with most Western countries achieving rates below the world average. The Asia-Pacific region, on the other hand, outperformed the world average for the same period with a growth rate of 8 percent.

In the 1990s (1990-98), global GDP growth slowed to 2.4 percent, whilst across the Asia-Pacific region, GDP growth averaged 8.1 percent. There were, however, dips in some countries’ performance within the region. China still took the lead in the 1990s with an average 11.1 percent annual economic growth rate, whilst Taiwan’s average GDP growth rate was 6.3 percent over the same period. Singapore’s economy grew by an average 6.6 percent in the 1980s, jumping to 8 percent in the 1990s. Malaysia also saw a jump in its annual economic growth from 5.3 percent in the 1980s to 7.7 percent during the 1990s. Japan’s economy slowed dramatically from 4 percent growth in the 1980s to just 1.3 percent in the 1990s. Growth in Hong Kong was also down from 6.9 percent in the 1980s to 4.4 percent in the 1990s. Compared to the 1980s, Indonesia and Thailand had moderately slow growth in the 1990s.

APEC accounted for 40 percent of the world’s trade in 1995. APEC’s share of world trade increased to 54 percent in 1997 before falling to 42 percent in 1998. It is clear that economic growth in the Asia-Pacific region was ahead of the world economy in the 1980s and throughout much of the 1990s, that is, until the Asian financial crisis broke out. The crisis pushed the ASEAN-4 (Indonesia, Malaysia, Thailand and the Philippines) into recession, with each registering negative economic growth rates of around -9.5 percent in 1998. Most of the economies in the region experienced recession unlike any they had seen for two decades.
III. Causes of the Asian Financial Crisis

One major cause behind the Asian financial crisis was the movement of international capital. International Monetary Fund (IMF) figures on net capital flow reveal the dramatic pace at which capital had taken flight from the Asian region once the financial crisis struck. If we look only at bank borrowing by the five crisis-hit countries (namely, the ASEAN-4 plus Korea), US$37.1 billion in loans had gone into these nations in 1996, slightly down from the US$49.2 billion in loans during 1995. In 1997, however, there was a drastic change in the situation as international banks fled en masse from the region. Total capital outflow surged to US$43.6 billion in 1997 with capital continuing to take flight in 1998 as a further US$28.2 billion was pulled out of the region. In 1999, capital outflow increased again to US$41.1 billion. After enjoying a long period of economic prosperity prior to the Asian financial crisis, the region had become complacent, accustomed as it was to matter-of-fact growth, and was caught completely unawares by the overnight withdrawal of foreign capital that followed the market reforms in Asia.

One should not ignore, however, the institutional factors at work when an economy moves from being a relatively closed to a much more open market. Market reform requires more than just liberalization of the flow of goods, services and capital. Developing countries also become more vulnerable to financial crises because of the deficiencies in, amongst other things, sound financial systems, adequate transparency, robust legal and regulatory frameworks, sound macroeconomic and monetary policies and good corporate governance.

IV. Importance of New Financial Architecture

The Asian financial crisis made economic crisis management one of the hottest issues for recent debate within the world’s governments, academic circles and the NGOs. The latest crisis has proved that the contagion effect from financial crises can spread very rapidly throughout the region. It also made clear the need to establish a regional financial mechanism, such as an Asian Monetary Fund, or other, similar regional financial arrangements capable of taking collective action as soon as a financial crisis breaks out.
No single country in the region should be left out of such a cooperative mechanism precisely because of the contagious nature of financial crises. Taking the currency depreciation in Taiwan in October 1997 as an example; the sudden depreciation of the New Taiwan dollar induced a contagion effect that led to a speculative attack on the Hong Kong dollar the following week and further triggered the collapse of the Korean won.

If a cooperative financial mechanism were to neglect or exclude any individual country in the same region, its ability to halt and contain a crisis would be greatly diminished. Furthermore, it is equally important to monitor the financial indicators to prevent the initial onslaught of a crisis. Of course, any regional financial architecture that should come into existence should also coordinate and cooperate with international organizations such as the IMF and the World Trade Organization (WTO). The role of the IMF in financial crises has now fueled debates over its functions. In consequence, it is now generally believed that the WTO can also play an important role in the process of opening markets by giving consideration to the prevention of future financial crises.