Economic Globalization and Political Stability in Developing Countries

PROJECT ON WORLD SECURITY
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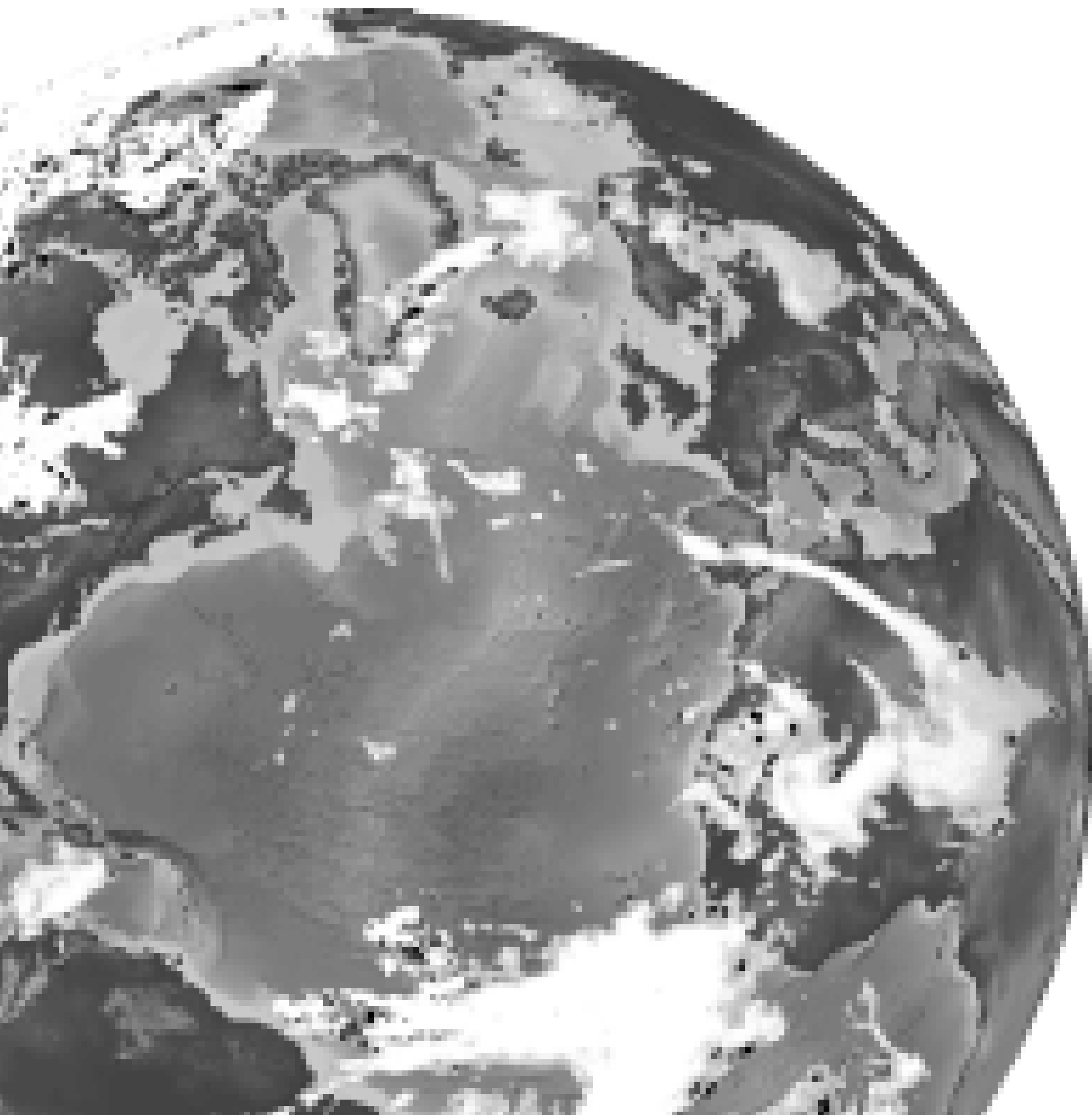

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SUMMARY

This essay assesses the impact of economic globalization on political stability in developing countries. It defines economic globalization as the process of integration of national economies. Economic globalization is distinguished from marketization, or the extension of market-based allocation processes through liberalization, privatization, and deregulation. Economic globalization and marketization overlap but need to be distinguished, as they have different impacts on politics in developing countries. The essay reviews the progress of economic globalization; in recent years, international economic integration has been spurred by dramatic increases in international financial flows and trade. Three factors explain this growth: the emergence of new information technologies, the efforts by governments to promote trade liberalization and international economic cooperation, and the emergence of increasingly global private companies with integrated processes of production. Nonetheless, the extent and novelty of the current trend of economic globalization should not be exaggerated. In many respects, the international economy is no more integrated than at the end of the nineteenth century. Most economies remain overwhelmingly national in scope and dynamic, and the sharp rise in financial and trade flows remains limited to a handful of developing countries.

Three mechanisms are postulated in the literature as leading economic globalization to have a negative effect on political stability in developing countries. First, it is argued that economic globalization promotes economic and social inequalities, but this essay reviews recent evidence that in fact there is no contemporary rise in inequality in developing countries. Moreover, the evidence suggests that integration into the world economy does not promote inequality. Second, many observers suggest that the volatility of the international economy, and the speed with which it imposes adjustments on national governments, is a source of instability. Our findings are that there probably has been an increase in volatility but suggest that governments seek the advantages of integration with the world economy because they believe that on balance it promotes stability. Too often, governments undertake economic reform measures only because the current policies are no longer sustainable. Instability is due to the process of reform, rather than the regime that emerges when reform is completed. Finally, we review evidence that economic globalization undermines state sovereignty. The essay agrees that capital mobility lessens the policy discretion of governments, but argues that it is important to distinguish between short and long term. In the short term, governments have less discretion than in the past. In the long run, however, this does not impose a set mold on policies, but allows several distinct approaches, as long as the long-term needs of capital are met.

The essay then examines whether or not economic globalization has enhanced the probability of ethnic conflict. Many observers suggest that growing ethnic conflict has resulted from growing economic uncertainty and austerity. The essay argues instead that the combination of economic globalization and marketization leaves

political leaders with fewer instruments with which to maintain political support, and so a resort to nationalist and cultural discourse becomes more attractive. In conclusion, it appears that, far from making states irrelevant, economic globalization puts additional pressures on states to perform key tasks. In the future, prosperity will depend increasingly on the capacity of states to manage change and provide key public goods—without which economic growth is impossible.

INTRODUCTION

This essay[1] assesses the impact of economic globalization on political stability in developing countries. Such an assessment is timely. It is hard to read a journalistic or scholarly account of any conflict in Africa, Asia, or Latin America which is not imputed in some way to economic globalization, or to a somewhat more vague appellation such as "global economic forces," the "new neoliberal order," "global capitalism," and so on. These accounts all suggest more or less explicitly that a multiplying number of new violent conflicts in developing countries are caused in some manner by recent changes in the world economy. What can be made of such claims? As tends to be the case with fashionable terms and concepts, unfortunately, these stories ascribe a variety of meanings to globalization and the precise manner in which it impacts on political stability. Some conflicts appear on closer inspection to result primarily not from recent changes in the world economy, but from political dynamics linked to the end of the Cold War and the disintegration of the Soviet Union. In other cases, economic forces interact in complicated ways with other factors that need to be disentangled. The objective of this essay is to clarify the causal links between economic globalization and instability in developing countries.

To achieve this aim, I review a large and growing literature that is varied in its concerns, conceptual clarity, and ideological baggage. There are disciplinary biases, for instance, in a mainstream economics literature which tends to be far more optimistic about the impact of the global economy on developing countries than the rest of the social sciences, which tend to be less sanguine. There are also regional biases: globalization clearly does not have exactly the same meaning in much of the literature on Africa, for example, that it has in the literature on East Asia or the ex-Soviet Union. I lay down some basic definitions and establish some important analytical distinctions in the first section, which follows.

The second and third sections focus on empirical evidence for the actual extent of globalization. A typical implication of much of the globalization literature is that recent changes in the world economy mark a fundamental historic break with the past. Thus, I want to track how far globalization has in fact progressed and how fast it is currently progressing. I argue that the proponents of globalization exaggerate the degree to which the current evolution breaks with the past.

Three overlapping but nonetheless distinct claims can be found in the literature about the impact of economic globalization on political stability in developing countries. Each is assessed in turn in the fourth through the sixth sections. A first view is that globalization exacerbates social stress on political systems in the developing world by increasing both intra- and inter-country income inequalities. The record, however, is far more ambiguous than is usually posited, as there is little evidence that globalization has promoted inequality over the last three decades. Second, some observers argue that the rapid economic policy change imposed by globalization promotes instability. Here too, my assessment nuances the impact of globalization. I find more convincing a third mechanism through which economic globalization is posited by many

[1] I wish to acknowledge helpful comments from Joan M. Nelson, Dennis Patterson, and Emma Rothchild on an earlier draft, as well as the participants at the Project on World Security Core Group Meeting at the Pocantico Conference Center of the Rockefeller Brothers Fund (April 24–25, 1997), at which this essay was presented; and very helpful research assistance from Gina Lambright.

observers as enhancing instability, namely by weakening the authority of Third World political structures over economic matters. These three claims overlap, of course, but I discuss each separately to highlight key analytical distinctions. Two themes in particular emerge in all three sections. First, it is important to distinguish economic globalization from marketization, or the extension of market processes, as the two have somewhat different dynamics and implications. Second, the political impact of economic globalization is likely to be mediated by a host of institutional factors and cannot be understood by itself.

In the seventh section, I then illustrate these dynamics by assessing the impact of globalization on the exacerbation of ethnic conflict in the developing world. The essay concludes with several implications of the argument.

1. DEFINING ECONOMIC GLOBALIZATION

I define economic globalization as the ongoing process of international economic integration. The term captures the notion that various forms of interactions between national economies are increasing. In practical terms, this means that the primary indicators of the extent of economic globalization are the proportion of national economies that are accounted for by international economic transactions, including primarily international flows of trade, capital, and labor. I do not include the less tangible transborder flow of *ideas*, unless that flow is recorded in national accounts, or — more accurately, given how much trade is not recorded—unless it engenders some kind of transborder payment. This restriction does not mean to suggest that the transborder flow of ideas is not important; rather, it results from the need to circumscribe our topic to a manageable dimension. Thus, we are interested in the economic impact of the sale of the latest Sylvester Stallone blockbuster to Latin American distributors, but will not have much to say about the cultural impact that the movie has on Latin American populations.

The literature often presents us with other, more general, definitions of economic globalization. First, globalization often denotes a process of *marketization*, or the notion that public institutions are in retreat relative to the growing reach of market-based allocation mechanisms. The "retreat of the state" is typically ascribed to a revolution in policy attitudes which one author has described as the "triumph of liberal economic ideas" (Biersteker 1995; Killick 1989) that is the recognition of the superiority of market-based outcomes which began to emerge in the early 1980s. According to many authors, this ideological conversion has led to a massive policy shift in much of the Third World towards the privatization and liberalization of production, which has powerful political implications for the countries in the region. In fact, the evidence does not suggest that such a shift has taken place in the last two decades: empirical studies have not found a substantial decline in the average size of the state relative to the national economy in either the developing world or in the countries of the OECD (Tanzi and Schuknecht 1995). While the legitimacy of liberal economic ideas may have grown in recent years, it remains too early to speak of the demise of the economic role of the state.

Nonetheless, insofar as marketization takes place and is linked to a need to enhance international competitiveness, it will be accompanied by international economic integration and is thus relevant to our discussion. It should be pointed out that marketization of the local economy will not necessarily result in greater integration, and vice versa. Oil exporters may be quite highly integrated in the world economy, for example, but highly "statist" in their internal policy regimes, while a big, low-income country like India has advanced far in the marketization of its economy in the last decade, but has remained relatively isolated from the world economy. In short, marketization and economic globalization do not necessarily coincide.

Second, some authors appear to use the term globalization to mean nothing less than the modern international economy itself, or to the global capitalist system. Thus, Jim

Mittelman (1996) in the same brief essay refers to globalization as a "phase in the history of capital," (p. 230) and "an ideology extolling the efficiency of free markets" (p. 231) as well as an ongoing process of economic integration (passim). Such claims are usually ambiguous regarding how new the process of globalization actually is. Indeed, some left-wing theoreticians have long posited that the logic of capitalism is inherently expansionist and thus has always been global in nature. Immanuel Wallerstein argued as early as 1974 that the international economy has been fully integrated since the sixteenth century under the aegis of capitalist modes of production (Wallerstein 1974). For Wallerstein, there does not appear to be an ongoing process of globalization, since the process has long been complete and only varies on the margins in relatively long cycles. Wallerstein's major contribution to a debate about globalization is to remind us that international economic integration is not a recent phenomenon (as seen later). But an approach that tells us that the essential dynamics of the international economy have not changed in four hundred years paints with too broad a brush to be really useful to us.

2. RECENT TRENDS: A GLOBAL ECONOMY?

In the last decade or so, a large and quite varied literature has emerged arguing that the integration of national economies has proceeded so far as to change the nature of international economic relations (Stallings 1995; McGrew and Lewis 1992; Schmidt 1995; Oman 1994; Ohmae 1995; World Bank 1996). Observers point in particular to the ever expanding volume of international capital movements and trade.

INTERNATIONAL FINANCE

The most striking manifestation of economic globalization is perhaps capital mobility. Overall, total net capital inflows to the developing world in 1995 totalled $193.7 billion according to the IMF, up from $43.5 billion as recently as 1990,[2] and including some $37 billion in portfolio investments (International Monetary Fund, 1996). Observers point to how recent this surge is (Griffith-Jones and Stallings 1995). In 1945, the combination of the Great Depression and World War II had reduced the international flow of capital to a trickle, and capital movements were hampered by strict national controls. Their steady if unspectacular growth in the following decades focused first on foreign direct investment (FDI) and then subsequently on commercial bank lending. High- and middle-income countries dominated these flows, while the low-income economies of Asia and Africa had access primarily to public flows from bilateral and multilateral aid agencies. FDI and commercial bank lending effectively dried up following the emergence of the debt crisis after 1982, with the exception of a small number of newly industrialized countries in East Asia. The current surge did not really begin until the end of the 1980s, fueled in part by low interest rates in the United States and in part by the earlier appreciation of the yen following the Plaza Accords in 1985.

It is worth disaggregating the different forms of international capital, which are not all equally mobile. Least mobile is FDI, or investment by firms in a country other than the one they are registered in. Substantial transaction costs will hamper firms that want to move operations but have sunk significant investments in a country, embodied typically in physical plants. Because of this, FDI is the riskiest form of investment, and most likely to be discouraged by economic and political instability. Total world FDI has nonetheless grown at a furious pace during the 1990s, growing from an average of $91.5 billion in the 1983–88 period to an estimated $235 billion in 1995 (United Nations 1995). In 1996, as a result, the global stock of FDI exceeded $2,700 billion, roughly double the 1988 level and equal to about 10 percent of world economic output (*The Financial Times* 1996).

At the other extreme are the highly mobile foreign exchange markets which have registered the fastest growth, thanks to the collapse of the fixed exchange rate regime in the early 1970s and the growth of electronic trading (see below). The daily transactions recorded by the Bank for International Settlements had stood at some $10–$20 billion as recently as 1973. After more than doubling in the first half of the 1990s, by 1995 they reached an astounding $1.3 trillion a day, in some 150,000

[2] All statistics in this essay should be treated with a grain of salt, as no two sources appear to agree on exact totals. They are offered here merely to provide a sense of general trends and magnitudes.

different transactions that seem impervious to effective regulation by national governments. By way of comparison, in 1995, *The Economist* noted that the total foreign-currency reserves of OECD governments amounted to $640 billion.

Slightly less mobile, finally, are a variety of portfolio assets such as debt instruments (e.g. bonds, commercial paper, certificates of deposit) and foreign equity investments. These have also undergone strong growth. Bond growth has been fueled by the rapidly rising amount of outstanding government debt, and government bonds now account for roughly a quarter of global financial assets (*The Economist* 1995). Cross-border ownership of equities is also increasing rapidly. In the developing world, equity markets have been spurred by the diversification of investment portfolios in the OECD countries; investment funds dedicated to emerging markets grew from 232 in 1990, with assets of $14 billion, to more than 1,000 in mid-1995, with assets of $132 billion (World Bank 1996).

TRADE

The recent growth of international trade has been particularly rapid, increasing on average at one-and-a-half times the rate of growth of world GDP between 1965 and 1990. The World Bank (1996) predicts that world trade will continue to grow at this rapid rate, with a forecast of over 6 percent annual growth for the 1995–2005 period. It predicts especially fast growth in the developing countries, with East Asia leading the way with growth of over 10 percent a year. It should be noted that the rate of growth of trade has varied across regions of the developing world. Thus, while East Asia managed an annual rate of increase in its exports of some 9.3 percent during the 1981–90 period, and Latin America managed a rate of 4.4 percent, sub-Saharan Africa's exports were entirely stagnant (World Bank 1996).

In addition to this pattern of rapid sustained growth, international trade is undergoing a significant qualitative change as well that will have a profound impact on domestic economies. The growth in the international trade of services is in the process of redefining what constitutes the tradable sector. This includes an array of services, from legal and accountancy expertise to insurance and banking that had always been considered untradable because of the logistical difficulty in exporting the service to an overseas client[3] as well as because of national legal, technical, and cultural norms. As economies have become more integrated however, and thanks to the development of information technologies, many services have become traded across borders, and services are the area of fastest trade growth today. Average annual growth in trade in commercial services from 1980 to 1993 was 7.7 percent, compared with 4.9 percent for merchandise trade (Primo Braga 1996). The erosion of distinct national services sectors is both symptomatic of greater economic integration, notably through the adoption of common norms and procedures, and serves to promote even more rapid integration, since the services sector underpins the very process of globalization. As Cable (1995) reminds us, international exchanges are greatly facilitated by services such as banking, transport, and insurance.

Three sets of factors are usually given credit for promoting this process of globalization. First, many observers stress the key role of certain technologies: on the one hand, innovations in transportation have lowered costs dramatically, making what had been non-tradable goods into goods that could be competitive in foreign

[3] Thus, the quintessential nontradable service is the haircut.

markets. On the other hand, spectacular advances in information technologies have sharply cut the cost of information and accelerated the speed at which it flows across borders. The role of information technologies is keenly felt in the area of finance, for example, as computerized trading has turned foreign exchange markets into twenty-four-hours-a-day extravaganzas involving incredible amounts of capital in interconnected markets all over the globe.

Secondly, observers stress the role of policymakers in the dominant economies who have promoted the growth of trade and international finance through the elimination of tariffs and other national barriers, as well as economic policy convergence. A host of international organizations, from the International Monetary Fund, to the GATT, WTO, and Bank for International Settlements have been established to promote economic integration, viewed as the best way to economic efficiency and growth (Block 1996; Griffith-Jones and Stallings 1995). The recently completed Uruguay Round of the GATT, and the achievements of such efforts at regional integration as NAFTA, the EU's Maastricht Treaty, or ASEAN and Mercosur in the developing world, have all promoted trade growth (Haggard 1995). The work of these international organizations has been complemented by national policy efforts to facilitate cross-border flows as well. Thus, UNCTAD's annual *World Investment Report* noted in 1995 that of the 373 legislative changes affecting FDI in fifty-seven countries between 1991 and 1994 only five were not in the direction of greater liberalization (UN 1995, p. xx).

Thirdly, and related to these first two factors, scholars like Gary Gereffi emphasize the growing tendencies of business firms to organize themselves across borders in "global commodity chains" (Gereffi 1995). A large number of multinational corporations now hold a significant proportion of their productive assets abroad. The UN estimates that some forty thousand transnational corporations control roughly one-third of the world's private-sector productive assets and generate about $5.5 trillion in sales from their foreign affiliates alone (UN 1995). The world's one hundred largest corporations undertake an average of 41 percent of their activities abroad (UN 1995, p. 26). As a result of the growth of this transnational sector, a growing proportion of international trade is composed of intra-firm transactions, in which, for example, a company in one country in Asia exports to the United States the electronic components made by a multinational corporation's factory to be assembled at a factory for sale in the U.S. Intra-firm trade is estimated to account for one-third of total world trade, some $1.6 trillion worth of exports in 1993 (UN 1995).

In East Asia, there is much evidence of elaborate systems of partnerships between companies in neighboring countries that have played a central role in the industrial development of the region. In different variants of what has been called the "Flying Geese" or "Product Cycle" model, relatively advanced countries like Japan moved labor-intensive components of production towards affiliates in poorer countries such as Korea and Taiwan. A decade later, a similar process occurred, with affiliates in yet poorer countries like Indonesia and Thailand playing the same role, as the first wave of countries moved into more technologically sophisticated subsectors. In this way, intra-firm arrangements facilitated the structural transformations of the region (Cumings 1984; UN 1995; Mitchell and Ravenhill 1995).

3. THE LIMITS OF GLOBALIZATION

Even if the trends and dynamics described in the previous paragraphs are all accurate, the extent and significance of globalization achieved to date remains probably much exaggerated. First, the notion that we are witnessing a major historical economic watershed seems overblown. Historians remind us that at least by certain measures, the international economy is no more integrated today than it had become by the latter half of the nineteenth century (Maddison 1989). For example, *The Economist* recently pointed out that for many industrialized countries, trade accounts for about the same proportion of GDP as it did a century ago. Similarly, the size of net capital flows between countries is not unprecedented; a century ago, as much as 40 percent of British savings was invested abroad (*The Economist* 1996), much of it to finance infrastructural development in Latin America and Eastern Europe.

The degree to which the economies of developing countries are more integrated into the world economy continues to vary substantially, and the data do not suggest a clear trend over the last couple of decades. A standard measure of openness is the proportion of GDP taken up by exports: in a small number of high-income countries, mostly in East Asia, the proportion is high and rising. It is not unusual for exports to total the equivalent of one-quarter of GDP. The picture for much of Latin America is quite different, however. Given a long tradition of import substitution industrialization, exports often amount to less than one-tenth of GDP. After a decade of liberalization, however, they are rising in many countries of the region. Finally, for the low-income countries of sub-Saharan Africa, the importance of trade relative to the local economy, while relatively high, actually went down in sixteen countries during this period, or about half the countries for which we have acceptable data (World Bank 1996). The World Bank estimates that for the entire continent, that proportion increased, from 20 to 27 percent between 1970 and 1993, but this increase seems related in large part to the dramatic increase in the value of oil during this period, a commodity exported by only a handful of countries in the region.[4]

The international mobility of labor also is no greater than in the past. With the exception of labor flows within the European Union, international labor markets remain highly segmented, even for highly skilled workers. Indeed, the present age can be sharply contrasted to the huge wave of migration that occurred in the second half of the nineteenth century, when tens of millions of Europeans migrated to the Americas, North and Southern Africa, and Australia; and similar numbers of Chinese and Indians migrated throughout the western hemisphere. Between 1880 and 1913, annual migration from Europe alone varied between six hundred thousand and 1.5 million individuals (Cable 1995).

The *quality* of the interaction with the global economy also varies across the developing world. Most low-income countries exhibit a pattern of trade with the West that has little changed over the last hundred years; for the most part these countries continue to export primary commodities and import manufacturing goods. Data from Africa suggest how little interaction with the world economy has changed;

[4] In 1993, 18 percent of all of sub-Saharan Africa's exports were accounted for by Nigerian oil exports.

Africa's integration into world trading markets is more longstanding than is often realized. As early as 1854 and several decades before formal colonial annexation, West Africa exported some 37,631 tons of palm oil to Great Britain, a total which would reach fifty thousand tons by the end of that century, complemented by another fifty thousand tons of palm kernels (Fieldhouse 1973, p. 129; see also Munro 1976). With the exception of oil, the primary commodities which dominated Africa's exports one hundred years ago do so today: cotton, cocoa, palm oil, gold, copper.

The Asian tigers have moved aggressively into dynamic manufacturing markets such as consumer electronics. They are now active participants in the management of the international economy through participation in organizations like WTO and regional ones like APEC (Haggard 1995). On the other hand, most of the low-income countries of the developing world have been marginal players in the process of trade liberalization which has played itself out in international fora in recent years; with the exception of big states such as India and China, they were largely absent from the debates of the Uruguay Round negotiations, which focused almost entirely on "north-north" issues. For example, the relatively high official tariff barriers that continue to prevail in Africa were never put on the negotiating table, and no concessions were asked of African governments (Sorsa 1996; Davenport, Hewitt, and Koning 1994).

In sum, it is important not to exaggerate the novelty of the current globalization trend. In many respects, it is merely only overturning the impact of Great Depression protectionism to return to levels of international integration and openness that had been achieved by the end of the nineteenth century. The one area where recent innovations truly do imply a historical discontinuity is in financial markets. To be sure, high levels of foreign direct investment (FDI) and international bond issues are also far from new, but what is unprecedented is the sheer *speed* with which these capital markets can now respond to price signals because of the new information technologies and the linking together of markets all over the world to ensure twenty-four-hours-a-day trading.

Second, the absence of economic convergence between national economies suggests how far the process of globalization still has to go. Standard economic theory would predict convergence in the prices for basic inputs and factors such as labor and capital and eventually in national incomes. This convergence is proceeding unevenly and slowly, if at all. Even in capital markets, clearly the most highly integrated market, economists point out that the predicted convergence in interest rates has simply not taken place, with the persistence of national divergences even in the most integrated economies such as those in Europe. Wade suggests that real interest rates vary from country to country by up to a factor of five; much less than the differential for labor, which varies as much as by a factor of fifty,[5] but larger nonetheless than would be the case in a highly integrated world economy (Wade 1996). More generally, while there has been convergence in the GNPs of OECD economies, the last couple of decades has not witnessed a convergence in national income between developed and developing economies. Pritchett (1996) has estimated that 70 percent of the economies in the developing world grew more slowly than the median rate of growth in the OECD between 1960 and 1990. Simply put, with the exception of about twenty countries or so, developing countries are not catching up to the rich countries, but have been falling further behind. Almost invariably, economic performance in

[5] In 1994, it cost $25 an hour to employ a production worker in Germany and $.50 or less in China, India, and Indonesia (*The Economist* 1994).

these countries has suffered from a lack of integration with the world economy. (Pritchett 1996; see also Seligson and Passé-Smith 1993; and Baumol 1986).

Third, and strongly related to this last point, many of the characteristics ascribed to globalization only concern a minority of mostly developed states. These are the countries, in Europe and North America, that are achieving *deep integration* through years of concerted policy coordination and negotiation.[6] While a small number of Asian countries have begun to pursue an agenda of deep integration in a variety of regional and international fora (Haggard 1995), they represent the exception rather than the rule.

The impressive growth in international trade is almost entirely accounted for by the two dozen states of the OECD and a handful of East-Asian economies. The OECD country share of international trade is above 80 percent and has been rising over the last twenty years, according to UNCTAD (UN 1996). Much the same can be said about FDI. True, FDI to the developing world has undergone a sharp increase in recent years, but again, most of it continues to occur between the major OECD economies. Thus, the U.S. remains the major recipient of FDI, with some 46 percent of world flows between 1985–89. Only 6 percent of FDI flows from the U.S. went to the developing countries in 1989–91 (UN 1995). Despite the growing popularity of international and emerging-market funds, American investors still keep 94 percent of their equity holdings in domestic securities. On the other side, even after a 50 percent increase in the first half of the 1990s, FDI to sub-Saharan Africa was still only $2.1 billion in 1995 (IMF 1996).

To summarize the discussion so far: while economic globalization has progressed rapidly in the last couple of decades, its novelty and breadth are probably exaggerated by the globalization literature. The process of integration of developing countries into the world economy continues to proceed at an uneven pace and with different dynamics across regions. While the information revolution is probably in the process of fundamentally helping to alter international economic relations, the process is still in its early stages. This should be remembered as we turn to assessing the political impact of economic globalization on developing countries. The literature suggests three mechanisms by which economic globalization affects political stability: it is argued to promote social inequality and economic volatility, while undermining state sovereignty. I assess each in turn.

[6] Deep integration is defined as the international coordination of domestic policies which have an international impact, and involves international agreement on, for example, labor, environmental, and competition policies which may have an impact on international exchanges. It is distinguished from "shallow" integration, which relates to the removal of policies which prevent international trade and investment.

4. ECONOMIC GLOBALIZATION AND SOCIAL INEQUALITY

The first mechanism through which economic globalization is often alleged to undermine political stability relates to its impact on inequality. Globalization is thought to promote social inequalities because capital is thought to be more mobile than labor. Whereas workers find it difficult to move across borders seeking better wages and living conditions, investors can more easily shift elements of their portfolios across borders in order to evade the national regulatory or tax regimes that lower the rates of return. This greater mobility of capital suggests the first political implication of globalization, the relative disempowerment of labor. As globalization progresses, governments will tend to shift the burden of taxation away from capital—which would only respond by moving to other more accommodating countries—to labor, which is less mobile and thus less able to evade the burden. It should be noted that political economy has long noted a "structural dependence on capital" on the part of governments in market economies (Lindblom 1977; Przeworski 1990), in the sense that taxing capital directly results in lower investment rates and thus eventually slower economic growth.

But the need to accommodate capital grows when it can "exit" entirely from the national economy. Even in the absence of government policy changes, economic globalization still places a downward pressure on wages since firms are better able to choose to locate where wages are low and unions weak, than are workers able to move to areas where demand for labor is strong and wages are high. A minority of highly skilled labor will retain some leverage by being somewhat more mobile across borders and/or by having skills that are in great demand in the emerging high-tech economy. Thus, the stagnation of real wages in OECD economies combined with growing disparities between skilled and unskilled labor have been ascribed to the dynamics of globalization (Rodrik 1997).

In sum, heightened capital mobility is argued to constrain government policymaking in a specific direction that has negative implications for labor. Economic globalization has led to predictions of a "race to the bottom," in which governments are forced to allow the progressive erosion of wages and labor standards in order to accommodate market forces in the name of "national competitiveness." As a result, without greater international cooperation, globalization could lead inexorably to increasing social inequalities, an evolution which a number of observers have said has already begun (Kapstein 1996; Wood 1995).

Joan Nelson's "Poverty, Inequality, and Conflict in Developing Countries" (also a publication of the Project on World Security of the Rockefeller Brothers Fund) reviews the evidence regarding the extent to which growing inequality exacerbates instability in developing countries, so I do not discuss that part of the equation. Instead, I ask what evidence is available that globalization has increased inequality in the developing world. In recent years, the notion that inequality is increasing there as a direct result of globalization processes has become an article of faith in certain

circles. Ethan Kapstein began his much-noted essay in *Foreign Affairs* in 1996 by arguing that "the global economy is leaving millions of disaffected workers in its train. Inequality, unemployment and endemic poverty have become its hand maidens." (Kapstein 1996, p.16).

On the left side of the political spectrum, Broad and Cavanaugh (1995), Block (1996), Walton and Seddon (1994) offer similar arguments (but see also Gordon 1988). In these views, capital mobility has engendered a "levelling down" process where the implacable search for short-term profits leads firms to seek countries with ever lower wages and working conditions. The end result is an increase in inequality both within and across nations: the owners of capital benefit everywhere relative to owners of labor, but the developed countries tend to get relatively richer since they own the lion's share of the capital. For the developing countries, the main consequence of international economic integration has been "a dramatic slow down in economic growth" (Block 1996, p. 26). The implication that FDI in developing countries slows down their growth rate relative to growth rates in the countries from which FDI originates is on the face of it implausible and has little or no empirical support. On the contrary, a number of studies have established a strong positive correlation between the ability to attract high levels of FDI and economic growth among developing countries, not only in the recent past (Sachs and Warner 1995; but see Edwards 1993), but also for most of the nineteenth and twentieth century (Reynolds 1983; Maddison 1989). The gap between the poorest and richest nations is not getting any smaller (Pritchett 1996), but this results from the continuing inability of the poorest countries to attract FDI.

This debate about the causes of international inequalities can be examined with respect to sub-Saharan Africa, the region of the world which performed most poorly in the 1980s. For critics, Africa suffered through this "lost decade" in large part because its governments were pressured by international financial institutions into excessive trade liberalization, in the context of "neoliberal" structural adjustment programs (e.g. Mosley and Weeks 1993). In fact, however, African countries have continued to resist opening up their economies, which remain the most closed in the developing world. According to the World Bank (1996), only twelve of the thirty-six African economies it rated were considered "fast" or "moderate" integrators, based on the index of integration described above, and the African region contained the majority of "weak" and "slow" integrators in the sample. Using several similar indicators, Sachs and Warner's study of the role of trade in development identifies thirty-five countries that were "closed" at the end of 1994; twenty-three of them were African. How much Africa was ever integrated into the world economy is open to empirical and conceptual debate; that its crisis in the 1980s was causally linked to a progressive "delinkage" from the world economy rather than growing integration with it seems incontrovertible.

What about intra-national inequalities? No one today disputes the strong evidence of growing inequality *within* the advanced economies of the OECD, in particular the United States. The debate focuses essentially on its causes, and many mainstream observers have disputed the view that it can be blamed on trade with the developing countries (e.g. Krugman 1996; Lawrence 1996). Instead, they argue that trade with the developing countries is too small relative to overall trade volume in the developed countries to have the kind of impact on labor markets claimed by Kapstein and

others. Instead, they argue that growing inequality in the West is driven largely by recent domestic technological breakthroughs, notably the new information technologies, which have lowered the demand for low-skilled labor. The jury is still out on this issue, but few observers now argue that the rise of inequality is primarily due to economic globalization.

On the other hand, there is little hard evidence to support the argument that inequality is increasing in developing countries. Data on income and asset distribution in the Third World is notoriously weak, perhaps the primary reason that controversies about inequality tend to persist. Luckily, over the course of the last couple of years, significantly improved cross-national data have come to be available. Deininger and Squire (1996) report on a new data set assembled at the World Bank that includes 682 observations for 108 countries of Gini coefficients[7] and the national income distribution by population quintiles. In both scope and reliability, these data represent a considerable improvement over all previously available data sets, even if they remain imperfect. Most useful, the data set includes fifty-eight countries with four or more quality observations spaced out from the 1960s to 1990s, thus allowing for a better understanding of the evolution of intra-national inequalities over time. A number of scholars have now taken advantage of this new data and have generated several findings of interest for our purpose here (Bruno, Ravallion, and Squire 1996; Deininger and Squire 1996; Ravallion and Chen 1996; Chen, Datt, and Ravallion 1994). Some of this data is related in the Appendix table.

First, the data suggest that income distribution has been fairly steady in most developing countries over the course of the last forty years. As Bruno, Ravallion, and Squire put it, there is "substantially greater variation in inequality across countries at a given time than over time for a given country" (p. 5). Parallel research on the evolution of poverty in developing countries (Ravallion and Chen 1996) suggests a similarly static evolution overall, although with sharper regional variation: the absolute incidence of poverty increased in Africa and Latin America (and the ex-socialist states) during the 1980s, while declining in East and South Asia. Overall, the absolute numbers of the poor have grown roughly as fast as population growth.

These data are perhaps too aggregated to capture significant trends in inequality. It is not inconceivable that in some countries, income is becoming more polarized between the very rich and the very poor, in a manner that is not fully picked up by a simple Gini coefficient. Nonetheless, arguments according to which inequality and poverty have been rising quickly in the developing world appear to be at the very least exaggerated, through the early 1990s. The notable exceptions to this stylized fact are the ex-socialist countries of Eastern Europe and the Soviet Union, where the collapse of Communism and the transition to market-based economies have resulted in a sharp increase in inequality.

Relatedly, the significant variation in inequality across countries exhibited in the Table, often with similar endowments and levels of development, suggests that it is domestic factors rather than international ones, that explain inequality. Indeed, Bruno, Ravallion, and Squire emphasize the central role of government policies in determining the distribution of income and assets. Progressive education and health policies, as well as redistributive policies such as land reform are much more important to the evolution of social inequalities in developing countries than the international economic environment.

[7] The Gini coefficient is a numerical measure of inequality ranging from zero (perfect equality) to one (perfect inequality).

Third, the data offer little support for the hypothesis that integration into the world economy has been a source of inequality or growing poverty. The Table also provides some summary statistics to bear this out. In addition to data about inequality, it provides data on the proportion of GDP represented by trade and a "speed of integration index" developed by the World Bank which tracks how fast a country was becoming integrated with the world economy during the 1980s.[8] There does not appear to be any correlation between the evolution of inequality over time and whether or not countries have pursued foreign-trade-driven development strategies and have become more integrated with the world economy over time. The one area of the world in which these data corroborate claims of growing inequality, albeit from a relatively more equal base, is the ex-socialist bloc. Here, however, it is difficult to disentangle the often temporary effects of adjusting to the massive policy changes occasioned by the "transition from socialism" from the more permanent effects of growing integration with the world capitalist economy.

In sum, there is little empirical evidence to support the predicted link between globalization and rising inequality within developing countries and little reason to believe that either can account for any rise in political instability, without reference to other, mediating, factors. The argument is sometimes made that even though overall inequality is not growing, "inter-group" inequality is growing, and that this is destabilizing. Clearly, income inequalities are more likely to spur political tensions the more they overlap with religious, communal, or ethnic divisions in a society. Certainly, in many, if not most, cases of protracted ethnic conflict, ethnic identity is intensified by the often well-justified perception of large differences in income and welfare levels between groups (Horowitz 1985). The overlapping of class and ethnicity has been a crucial dimension of the conflicts in Northern Ireland, Yugoslavia, Rwanda, and Lebanon, to cite just four obvious examples. Perhaps this inter-group inequality is increasing. But it is difficult to see how it would be related to economic globalization: it is far more likely that inter-group inequality is mediated mostly by domestic factors such as patterns of public expenditure and taxation.

Why has globalization not resulted in the expected sharp rise in inequality? It may well be that the trend is still in its early stages and will be picked up in due time as economic globalization intensifies. It may be that capital in the international economy is still not nearly mobile enough to have the predicted effect on labor. Finally, and most likely, the actual relationship between labor and capital may be more complex than assumed by the "race-to-the-bottom" viewpoint. After all, if nominal labor costs were the only consideration for investment decisions, the poorest countries of Africa and Asia would be draining all of the world's capital. In fact, of course, investors worry much more about the real cost of labor, taking into account labor productivity. As a result, high-wage countries remain more competitive than low-income countries, which exhibit very low levels of productivity. Furthermore, investment decisions are influenced by a complex mixture of factors besides the cost of labor, including the access to markets, the prospects for political and economic stability, the quality of infrastructure and so on. Lawrence, Rodrik, and Whalley (1996) have even presented tentative cross-national evidence that low labor standards actually deter FDI, suggesting that low nominal labor costs may be associated with low productivity and other disincentives to investment.

[8] The index incorporates four dimensions: the ratio of real trade to GDP, the ratio of FDI to GDP, the credit ratings of *The Institutional Investor* magazine and the share of manufactures in exports (World Bank 1996, pp. 20-29).

It can of course be argued that it is not actual inequality that matters so much as its *perception*. Thus, it is sometimes argued that the communications revolution is enhancing people's expectations and exacerbating their sense of economic grievance. Third World populations learn about American life styles on television, and their aspiration for a life style that is inaccessible to them enhances their sense of inequality, even if the average citizen is benefiting from improvements in his or her quality of life. The inevitable resulting frustrations fuel political instability. This is certainly a plausible claim, and there is much anecdotal evidence to back it up. *The Economist* recently argued that perceptions of growing inequality, poverty, and violence in Latin America were leading to a "populist backlash" against economic liberalization in the region. It wrote that "the fundamental economic outlook is favorable. But the poor can not eat 'fundamentals'," and it cited polls which suggest that above 70 percent of the population of Latin America are not very satisfied with the functioning of democracy in their country (*The Economist* 1996). In the absence of good longitudinal public-opinion data from the developing world, it is difficult to interpret such polls with confidence, or to generalize from them to other regions of the Third World. They are suggestive, nonetheless, that objective economic circumstances do not necessarily match popular perceptions of the economy, particularly during periods of change.

5. GLOBALIZATION AND ECONOMIC INSTABILITY

A second set of arguments about the negative political impact of globalization posits that international economic integration fuels instability because it speeds up the pace of economic change, placing extra stress on already vulnerable social systems. International economic integration, it is argued, is increasing the *volatility* of the international economy and the *speed* at which national economies are forced to evolve. Given the pressure to maintain international competitiveness, governments have less time to adjust to changes in the international environment. They can not deviate even briefly from an economic policy orthodoxy that is dictated by Western financiers, even when it implies austerity-inducing stabilization policies that are clearly against the expressed wishes of their electorate. Here too, the changes are alleged to have a disturbing impact on public opinion. The need to maintain competitiveness increases the pace of change and disrupts people's lives; job tenures are less secure, many social benefits apparently threatened. Even if incomes continue to rise and objective measures of welfare continue to improve, the pace of change leaves people with a deep sense of insecurity, which may lead to various political grievances and eventually instability.

There can be little doubt that the highly volatile nature of international finance complicates economic management, particularly in the smaller, more vulnerable countries of the developing world. In the *short run*, markets are volatile: they overreact to certain signals, can be slow to respond to imbalances, and then overshoot equilibrium prices when they do respond. Even virtuous governments can find themselves destabilized by international speculation, as happened in Latin America in the wake of the Mexican bond collapse in 1994. In what was dubbed the Tequila Effect, neighboring countries that did not always share Mexico's macroeconomic weaknesses nonetheless found their stock markets plunging downwards and their bonds seriously undermined. Equity investments in emerging stock markets proved particularly volatile: after a tenfold increase between 1990 and 1993, they were halved between 1993 and 1995 (World Bank 1996). In the *medium to long run*, however, steady and sustainable macroeconomic management is consistently rewarded by financial markets, as indeed was demonstrated by many of the economies in Latin America after the Tequila Effect subsided, and the confidence of financial markets was restored.

Much of the literature on the break-up of the Soviet Union, or on the ongoing conflict in the Balkans has argued that the policy reforms that these countries undertook to rejoin the world market economy had socioeconomic effects which led directly to political instability. An eloquent and well-researched example of this line of argument is offered by Woodward in *Balkan Tragedy* (1995). She argues that,

> The austerities of policies of demand repression led to conditions that could not easily foster a political culture of tolerance and compromise. Instead, the social bases for stable government and democratization were being radically

> narrowed by economic polarization between rich and poor, fiscal crises for most government budgets, de-industrialization without prospects of new investment in poorer regions, growing uncertainty and individuals' resort to nonmonetary means of obtaining necessities because of rising inflation, and serious unemployment among young people and unskilled workers that began to affect even the secure jobs and incomes of public-sector professionals, skilled workers, administrators and their children" (p. 383).

For observers like Woodward, in other words, the transition from socialism in these countries has fueled instability by dramatically undermining social structures and changing popular attitudes. Similar arguments have been made about the rise of conflict in the Third World, linking it to World Bank and IMF-led programs of economic liberalization and privatization (e.g. Kohli 1993; Walton and Seddon 1994). For instance, a number of observers have argued that the rise of ethnic conflict in Rwanda and Burundi in the 1990s was directly related to their economic crises and IFI-led reform attempts (e.g. Newbury 1992; Longman 1998).

Several points can be made about such arguments: first, there can be little doubt that economic policy reform is politically difficult. As Woodward argues, economic reform "fundamentally alters the existing distribution of rights and power" (p. 384; see also Rodrik 1996). In many cases, reform entails austerity and sharp cuts in consumption levels. Insofar as policy reform creates winners and losers, governments must find ways to weaken or isolate certain classes of often well-organized and powerful interests linked to the old policy regime while also shaping a coalition on behalf of the interests that will benefit from the new policies. This is particularly difficult to achieve when reform is dominated by an agenda of economic liberalization, privatization, and deregulation, as recent policy reforms have been. These reforms take away government's discretion to accommodate winners and losers with skillful dispensing of state resources, in the form of patronage or subsidies, particularly when they take place in a climate of economic austerity and resource scarcity.

Moreover, economic reform rarely yields quick results. Even in middle-income countries with established business communities and substantial infrastructure, governments may have to sustain politically thankless austerity policies for several years before investors respond to the new policies, and growth resumes. In low-income countries, where fewer of the prerequisites for rapid growth are present, this wait may stretch out even longer, as is suggested by the recent experience in Africa (Aron 1995; Gyimah Boadi and van de Walle 1996). Governments are in a bind. Any loosening of the macroeconomic reins to placate what becomes an increasingly restless population, serves as a negative signal to investors, who defer investments until they are confident that policy reforms are irreversible. Yet, to sustain the effort in political terms, governments need to be able to show some sign of progress to their citizens. The kind of incremental, "two-steps-forward-one-step-backwards" progress that governments prefer for political reasons buys them time, but ensures a less-than-enthusiastic response from markets and the need to persevere yet longer with austerity policies.

Second, however, recall the distinction between marketization and globalization made above. Transitions from socialism are first and foremost processes of marketization. Although the ultimate objective of the policy reforms undertaken in Yugoslavia in the early 1990s may have been to increase the country's international competitiveness, the

reforms were still in their infancy and had not yet had much impact on the country's relationship with the world economy. Moreover, it is clearly the *process of change*, undertaken in a hurried and chaotic manner, which is destabilizing, rather than the liberal economy which was to emerge at the end of the process of reform. In other words, it is the reform period of marketization which is argued to be destabilizing, rather than the open policy regime to emerge at the end of the reform process.

Third, these arguments about the destabilizing effect of policy reform are not always based on a convincing *counterfactual*, in other words, what would have happened in the absence of reform. Countries like Yugoslavia or Rwanda typically undertake economic reform to overcome substantial fiscal and monetary crises. It can rarely be argued with any degree of confidence that political stability would be better served by the absence of policy reform and the maintenance of what have become clearly unsustainable economic policies. Indeed, it is likely that leaders undertake reform only when they have become persuaded it better serves their interests than the status quo (Nelson 1984; Rodrik 1996). Moving from a set of closed economic policies to a policy regime that actively seeks integration with the world economy typically represents a calculated gamble that the local economy will benefit enough from the capital and technology available on world markets to overcome whatever increase in volatility is occasioned by closer integration. That gamble may not be attractive to the leaders of the handful of remaining closed economies that, like North Korea, have managed to avoid fiscal crisis. But the previously closed economies that have undergone economic liberalization in the 1990s are invariably countries whose previous policies had brought them to the brink of disaster and could no longer be sustained. For the leaders of essentially bankrupt and illegitimate regimes of countries like Yugoslavia in the early 1990s, reaching out to the West was perhaps the least dangerous option.

Fourth, to be convincing, the attempt to link globalization and instability must ultimately specify the precise mechanisms by which economic factors come to impact on political systems. As Nelson argues in "Poverty, Inequality, and Conflict in Developing Countries," by themselves economic forces probably have an indeterminate impact on politics. At best, they provide the context or background in which social and political institutions interact with individual agents in the political arena. Even if it could be demonstrated that integration into the world economy had doubled the probability of political violence in a well-defined sample of countries, to understand how and when violence had actually broken out, or why violence had not broken out in the other half of the sample, it would remain necessary to examine the country's political culture, its institutions of political accommodation and conflict mediation, as well as the actions of its politicians. It is for this reason that arguments about the impact of economic globalization are most convincing when they examine its impact on domestic political institutions. I now turn to the most prominent of these arguments.

6. ECONOMIC GLOBALIZATION AND STATE SOVEREIGNTY

For many observers, economic globalization's strongest political impact lies in the way in which it undermines national sovereignty and weakens states by lessening the degree of policy discretion available to governments that want to maintain sustainable policies. Even as economic globalization exacerbates inequality and economic volatility, its critics often assert, it undermines the ability of governments to address adequately these problems, which only adds to the possibility of instability (Frieden 1991; Cohen 1996; Haggard and Maxfield 1996; Marshall 1996; Strange 1995). There are thus two claims worth assessing: first, that economic globalization strips states in the developing world of decision-making power in the economic realm and, second, that this leads to instability. Let us examine each in turn.

What does it mean to say that economic globalization undermines sovereignty? In the overblown language of the business guru, Ohmae exclaims that as a result of "fundamental changes" in the world economy, "nation states have *already* [*sic*] lost their role as meaningful units of participation in the global economy of today's borderless world" (Ohmae 1995, p. 11). For Ohmae, the critical variable is the modern international conglomerate and its increasingly global strategies and production processes. The largest firms, with billions worth of assets and operations all over the globe, obviously can rival the power of the weaker states in the international community, and have considerable discretionary power even vis-à-vis the most powerful states.

Most observers suggest nonetheless that the international mobility of capital is more significant than the emergence of multinational conglomerates in the weakening of state sovereignty. Capital mobility weakens the ability of governments to pursue independent monetary and fiscal policy. In particular, in a world of fully mobile capital, national policy loses control of either the exchange rate or the national interest rate. Governments can no longer set both. In a flexible exchange rate system, any policy that has a negative effect on the real, risk-adjusted, return to holders of financial assets will result in a outflow of capital to other markets holding the promise of higher returns, and will eventually result in currency depreciation. In sum, changes in monetary policy will only affect the value of the national currency.

Governments that try to implement alternative economic policies at odds with those of the most powerful economies in the West, will see themselves eventually punished by the market. An example often given of this phenomenon is the dramatic failure of France's go-it-alone reflation of the early 1980s under the first socialist government led by François Mitterand. Although growth was briefly spurred, these policies resulted in a dramatic capital outflow that required three devaluations between 1981 and 1983, and eventually convinced the Socialists to adopt the policy of the "Franc Fort" and convergence on the much more conservative policies set by the German Bundesbank (Hall 1986). The power of international capital markets vis-à-vis sovereign governments is not new, but has grown exponentially in recent years;

as *The Economist* (1995) has pointed out, the Wilson government in Great Britain was able to stave off devaluation of sterling for three years in the 1960s with judicious intervention by the Bank of England, whereas in 1992, financial speculators forced sterling's delinkage from the European Monetary System's exchange-rate mechanism, despite the Major government's expressed intentions, in a matter of days. With much less active financial markets in the past, governments could sustain situations of macroeconomic disequilibria for much longer periods than they can today.

Powerful OECD economies like France and Great Britain nonetheless retain more leverage than the smaller economies of the developing world. For many observers, the Mexican Bond crisis of 1994 and the ensuing Tequila Effect provided a good example of the capricious power of international finance vis-à-vis developing country governments: overnight, financial speculation clobbered not only Mexico, punishing it for its large current account deficit, but also other Latin American economies with much better macroeconomic fundamentals. As Thomas Friedman has put it, "You could almost say that we live again in a two-superpower world. There is the U.S. and there is Moody's. The U.S. can destroy a country by leveling it with bombs; Moody's can destroy a country by downgrading its bonds" (Cohen 1996, p. 282). For many observers, the international bond market is proving a lot more arbitrary and unpredictable than American foreign policy.

Third World governments, it has been concluded, are powerless to fight the *diktat* of international finance, or as Mkandawire puts it, developing countries have been left "choiceless" by international economic forces (Mkandawire 1996; see also Ake 1998). At the present, this remains an exaggeration. To understand exactly how economic globalization circumscribes policy choices, it is useful to distinguish the short and long run. In the long run, I would argue that Economic globalization is serving to lessen the number of *good choices*. Developing countries can still choose to adopt policies of economic isolation and autarchy—witness countries like Libya, North Korea, or Cuba. Such policies have always led to slower growth and endemic balance-of-payments crises; today, in addition, the growing availability of international capital dramatically increases the opportunity cost of not engaging the world economy. Closed economies forgo not only access to international capital, but also access to technology transfers, commercial expertise and skilled labor that comes with it.

That does not mean that all countries are forced into a single, "neoliberal" policy mold, as is sometimes argued. The sharp differences which remain among the highly integrated economies of the OECD suggest that governments retain important degrees of policy initiative and discretion, at least at present levels of global integration. After all, Scandinavian and Northern European social democracy, with its higher levels of taxation, public expenditures, and various corporatist arrangements between the state, business, and labor, appears to be as sustainable as the more laissez-faire regime in the United States (Stallings 1995; Berger and Dore 1996). Even within the European Union, where policy convergence has been actively promoted for several decades, there remain sharp differences in the position of the state, with the proportion of central government expenditures in total GDP varying between some 30 and 50 percent.

Attracting and retaining capital in the globalized economy thus appears to be compatible with several distinct political economies. Maintaining long-term

competitiveness does seem to require focusing government efforts on various types of physical and human capital investments. Countries with public policies that improve education and infrastructure, facilitate labor flexibility, and support growth industries will be rewarded. Far from a race to the bottom, competition will entail a no-less-difficult race to provide an array of public goods which promote economic adaptation and innovation. The great difficulty for the states of the future will concern how to limit taxation so as to not antagonize capital holders, while at the same time providing the expensive public goods that ensure long-term competitiveness, and simultaneously finding mechanisms that at least partly buffer citizens from the volatility of the global economy.

In the short run, on the other hand, states that choose to engage the world economy for the promise of access to much greater capital, pay the price of having to accept greater volatility and less policy discretion. If they have come to rely on international capital to finance their economic growth, governments must accommodate it with more conservative management of the macroeconomy. To attract and maintain investment, they must keep taxes on business low. Economic management appears to be a thankless task, in which governments can never rest on their laurels and must ever maintain discipline. Comparing North and South Korea is instructive in this respect. With periodic labor and student unrest, South Korea appears paradoxically less stable. Despite an average annual GDP growth rate of 7.7 percent during the 1990s, there is today much talk of the end of the "Korean miracle," as the record of rapid growth is threatened by rising wages and competition from poorer economies in Southeast Asia, and the economy is struggling to move into new product cycles (*The New York Times* 1997; *The Economist* 1997). At least from a distance, on the other hand, North Korea appears to be a haven of stability. Having never attracted any foreign investors, the government need not worry about disappointing them, and decision makers do not lose sleep over the reaction of Wall Street to their every policy pronouncement. In the short run, the North Korean government probably has more latitude in its fiscal and monetary policies than its southern counterpart, at least in the sense, say, that no policy initiative it takes could result in an instantaneous run on its currency. On the other hand, its policies have produced a backward economy of little innovation, slow growth, and chronic food shortages.

What about the second claim, that economic globalization complicates the state's ability to manage conflict and change? Many observers proceed from the claim that globalization weakens central states directly to the claim that it leads to political instability. As Bardhan puts it, the "global integration of commodity and capital markets severely reduces the policy options of the nation-state, disrupts the process of building the institutions that govern the incipient national economy and weakens the state's capacity to mediate in ethnic disputes" (Bardhan, p. 12). The argument is probably well founded in the short run. The state's political management is particularly weakened if and when economic globalization is accompanied by marketiszation. In other words, the emphasis on liberalization, privatization, and deregulation strips governments of traditional political instruments, such as patronage or the selective distribution of monopoly rents, licenses, import duty exemptions, and subsidies. Without these resources, it is harder for governments to "grease the squeaky wheel," or coopt opposition and consolidate support with state favors. To retain this discretion, while at the same time gaining the growth advantages of economic globalization, developing-country governments seek to maximize integration into

the world economy while minimizing marketization. While they recognize and worry about the power of multinational corporations, they are likely to promote FDI much more assiduously than trade liberalization or privatization. They are most ambivalent about the policy areas for which economic globalization and marketization overlap, for example the liberalization of foreign exchange markets, where they face a direct trade-off between economic benefit and loss of sovereignty.

In that sense then, states are weakened by integration into the world economy. It should be pointed out, however, that in at least one respect, states are strengthened by their international links: states can borrow capital on international markets. The dramatic rise in the international indebtedness of governments all over the world suggests that the international arena actually offers a way for governments to expand their budget constraint. In effect, capital mobility allows governments to sustain bigger budget and current account deficits than they otherwise would be able to. In the long run, the market will discipline highly indebted governments, but in the short run, it will allow them an extra margin, which can be used for the purpose of political management. Thus, complaints during the Mexican collapse of 1994 that international financial markets could have dramatic consequences for political stability were losing sight of the fact that those same markets had allowed the government to run huge current account deficits during the run up to the Presidential elections.

7. GLOBALIZATION AND ETHNIC CONFLICT

Resorting to larger public sector deficits is probably one of the adaptations governments will make to the pressures and opportunities they face because of economic globalization. Another one, posited by observers like Cable (1995), is a greater resort to various forms of cultural nationalism. Further focusing on the relationship between economic globalization and ethnic conflict will help extend and illustrate the dynamics we have assessed in the last three sections. Many observers have blamed economic globalization for the alleged rise of ethnic conflict, by arguing that economic uncertainty and weakened governments make it more likely. In fact, the evidence that ethnic conflict is growing is so far mixed. In their "Minorities at Risk" project, Ted Robert Gurr and his colleagues have tracked the outbreak of ethno-political conflict. Their latest reports suggest a decline in the total incidence of ethnic conflict during the 1990s after a long period of steady increase from the 1950s to the early 1980s (Gurr 1996).

Much of the new ethnic violence, moreover, appears to result from dynamics linked to the end of the Cold War, rather than to changes in the international economy. Even some ethnic conflicts which cannot be imputed to the Cold War's end are not necessarily linked to economic globalization. For example, if there is an underlying economic explanation for the genocide in Rwanda, it seems much more likely to be linked to population pressures in the densely populated Rwandan countryside. In fact, André and Platteau's (1996) careful study of land pressures in Rwanda in the 1988–1993 period suggests a tragically Malthusian logic for the genocide that occurred in 1994. Their study chronicles the incredible stresses due to sharply rising landlessness and rural inequality in a region in which population density totaled just under 800 people per square kilometer and the mean household land-holding amounted to less than a half a hectare and was divided into nine separate plots!

Why would we expect economic globalization to promote ethnic conflict? Most arguments are in fact either about the effects of policy reform, along the lines just discussed, or about the effects of marketization. Thus market liberalization is argued to accentuate ethnic problems by increasing social inequalities and dislocation, and in the process exacerbating groups' anxieties and grievances (Bardhan n.d.). Marketization can set off economic competition between ethnic groups in a wide variety of settings and relationships. At the same time, as Bardhan notes, market allocation mechanisms can also serve to weaken ethnicity. "Markets and profit opportunities give salience to incentives at the individual level and thus may undermine the hold of collective passions....markets by improving outside opportunities and exit options for individual members of an ethnic group may reduce the effectiveness of its social sanctions and norms and thus its cohesiveness, resulting in a devaluation of ethnic networking and exclusiveness" (Bardhan, p. 11). Here too, it appears that by themselves the impact of global economic forces on political stability are indeterminate, and not necessarily negative.

I agree that ethnic conflict may rise in the future, but I posit a different mechanism by which it will intensify. As governments lose discretion over the economy and can no longer rely as much on material inducements to manage political stability, they will come to focus their attention and discourse on areas of public life in which they retain discretion. One such potentially highly charged area is culture. The language of nationalism and the sense of shared community that it evokes have always constituted a privileged instrument with which to establish and maintain popular legitimacy, but may well become more attractive to politicians as economic globalization increases. Cultural nationalism can take different forms. Some governments will seek to build popular support on an ideology of national development, in which the nation is united around the need to make sacrifices in the name of competitiveness (Cable 1995). Such an ideology, perhaps typified by the current government in Singapore, serves to legitimate the policy choices imposed by integration into the world economy. It will obviously be easier to sustain in rapidly growing economies in which most of the sacrifices asked of the population are relative rather than absolute. The difficulty for governments in less successful economies will be to avoid a slippage into aggressive mercantilism with, for instance, popular pressures to engage in trade wars or protectionism.

Another form of nationalism that will hold appeal to politicians will be the symbolic politics of ethnicity and cultural identity. Unable to offer material rewards to their followers, they will be tempted to offer membership in an "imaginary community." In some cases, the latter directly serves to compensate for the absence of the former; in other words, cultural politics offers targets to scapegoat for increasing economic difficulties and uncertainties. Members of other communities can be blamed for unemployment or declining wages, a phenomenon already widely observed in the form of anti-immigrant politics. Indeed, the rise of this negative form of cultural politics is evident not only in the West, but also in much of the Third World. The BJP Party in India, for example, combines laissez-faire economic doctrines with Hindu nationalism (Manor 1996), while Herbst (1997) has noted the rising tendency of Africans to redefine citizenship, with the intent to exclude segments of the population. Ethnic politicians like Milosevic in Serbia have existed throughout the modern age. They may become more common as political leaders are able to offer fewer material rewards to their followers.

In sum, economic forces alone cannot explain phenomena like ethnic conflict. They should be understood as providing the context in which political institutions and individual political actors interact to determine outcomes. To understand explosions of ethnic violence, it is not enough to posit the role of broad economic forces, but necessary instead to examine the play of political and institutional dynamics. In a fascinating analysis of ethnic conflict in the ex-Soviet Union, Roeder (1995) argues against the notion that ethnic conflict is related to the transition from a control to a market economy. Instead, his explanation focuses on how regional political entrepreneurs challenged the central state for power and resources, in the context of collapsing central Soviet institutions.

> The institutions of Ethno-federalism created in the communist era encouraged leaders within the homelands to create ethnic machines. In the successor states, many leaders of regional governments have turned to ethnic strategies as a way to save these machines and to improve the chances of their own survival... (Roeder 1995, p. 7).

Roeder distinguishes the sociological impact of a market economy from the political dynamics in political systems which are evolving towards market allocation from central control. Thus, for example, liberalization and privatization of production create "many new opportunities for regional officials to seize those assets that will generate appropriable assets" (p. 22–23). Regional officials who play the "ethnic card" can attract followers because in addition to appealing to an "imagined community," they can offer material rewards (p. 29).

CONCLUDING REMARKS

Sam Huntington argued thirty years ago that the capacity of political institutions to manage rapid change was the central conundrum of politics in the developing world (Huntington 1968). The preceding discussion suggests that economic globalization both accelerates the pace of change faced by developing country governments and weakens their discretionary power to manage change. This only confirms a key theme of this essay: far from making states irrelevant, ironically, the continued growth of economic globalization will place an ever greater premium on state capacity and legitimacy to ensure stability and economic prosperity. It will become increasingly easy to distinguish states according to whether or not they possess these qualities in adequate supply.

A small number of governments in the developing world that are disciplined and benefit from capable state institutions will continue to be integrated into the global economy without too much difficulty. They will weather the episodes of short-run volatility from international financial markets and will enjoy faster growth, thanks to access to foreign capital and technology. At the other extreme are the smallest low-income countries, primarily based in sub-Saharan Africa, which have so far failed to take advantage of global integration, and who are facing a progressive delinkage from the world economy. Deficiencies in the quality of their labor force, infrastructure, and governance will continue to militate against their integration. Economic globalization holds relatively few dangers for them because they have never interested private global finance. The public policy challenge for these countries and their donors will be to find ways to relink them with the world economy. The danger is that they will be attempting this transition at a time when “aid fatigue” is overtaking the traditional donor countries.

In between these two extremes are most states in the developing world. Globalization holds opportunities and risks for them. The promise of faster growth and employment for their rapidly increasing labor force will be counterbalanced by the danger that they will not be able to maintain macroeconomic discipline in the short term nor to provide the necessary public goods in the long run. As the pace of change increases, the managerial and political capacity of these states will be sorely tested. Will their governments avoid the sirens of debt to manage the more volatile business cycle? Will they find the discipline to invest in a more productive labor force, with investments in education and health that hold no immediate tangible return? Will their citizens be tempted by populist and ethnic entrepreneurs who offer temptingly easy solutions to their difficulties? The answers that countries give to these questions will in no small part determine the extent to which the twenty-first century is a peaceful and prosperous one.

APPENDIX: TABLE

REGION/COUNTRY	INEQUALITY (GINI COEFFICIENTS)					INTEGRATION	
	AVERAGE GINI [1]	1960s [2]	1970s	1980s	1990s	TRADE: % OF GDP (AVG. 92-94) [3]	SPEED OF INTEGRATION INDEX [4]
LATIN AMERICA AND THE CARIBBEAN	49.78	53.24	49.06	49.75	49.31	0.0960	-0.23
Brazil	57.32		59.00	55.60		0.0884	-0.28
Mexico	53.85	55.30	49.70			0.1114	1.44
SUB-SAHARAN AFRICA	46.05	49.90	48.19	43.46	46.95	0.2255	-0.46
Ghana*	35.13					0.1548*	0.56
Kenya	54.39**					0.2407	0.00
Nigeria	38.55					0.3488	-1.87
EAST ASIA AND THE PACIFIC	38.75	37.43	39.88	38.70	38.09	0.2394	0.77
China	32.68			31.50	36.20	0.2051	-0.29
Japan	34.82	35.60	34.10	34.40	35.00	0.0883	-0.39
Korea, Republic of	34.19	31.50	36.10	35.60		0.2538	0.63
Taiwan (China)	29.62	31.20	29.30	29.00	30.50		0.77
SOUTH ASIA	35.08	36.23	33.95	35.01	31.88	0.1047	0.87
India	32.55	31.50	30.90	31.40	31.10	0.0910	0.01
EASTERN EUROPE	26.57	25.09	24.63	25.01	28.94		0.46
MIDDLE EAST AND NORTH AFRICA*	40.49	41.93	41.93	40.45	38.03	0.2568*	-0.19
Egypt, Arab Republic of	38.00					0.0781	-0.19
INDUSTRIAL COUNTRIES AND HIGH-INCOME DEVELOPING COUNTRIES	34.31	35.03	34.76	33.23	33.75	0.1586	0.31
France	43.11	48.00	41.60	37.80		0.1725	0.93
Germany	31.22		36.00	35.80	45.40	0.2160	-0.07
United States	35.28	34.60	34.50	36.90	37.90	0.0742	-0.28

* For Ghana and region of Middle East and North Africa, data were only available for two years.

** Average Gini coefficient for Kenya is based on only one observation.

[1] Data on overall average Gini coefficients and regional decadal averages were obtained from Deinger and Squire (1995).

[2] Data on decadal averages for the individual countries were obtained from Bruno, Ravallion and Squire.

[3] Trade as a % of GDP were obtained from World Development Reports for 1994, 1995, and 1996. Average trade as percentage of GDP was calculated using total GDP and export figures for 1992, 1993, and 1994.

[4] Data on Speed of Integration were obtained from Global Economic Prospects and the Developing Countries (World Bank 1996).

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