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CHAPTER 1

# The Blessings and Perils of Globalization: A Tale of Two Peoples

A strong argument can be made that globalization and the unrestricted flow of capital, goods, and services lead to creation of wealth and prosperity among all participating nations. Comparative advantage allows both industrially advanced nations and developing countries to maximize their gains from trade. Industrially advanced countries make better use of their technology and capital by exporting it to less developed or poorer countries, which in turn make better use of their cheap and abundant labor by exporting their low-tech, labor-intensive products to the richer countries.[1] Globalization also leads to economic integration and convergence in economic policies around the world. Economic integration leads to economic growth through reform and harmonization in the countries' fiscal and monetary policies, tax systems, ownership patterns, and other regulatory arrangements.[2]

In the current context of globalization, with its concomitant free trade and global integration of national economies, the role of large multinational corporations (MNCs) is becoming increasingly critical to the growth and development of emerging nations. MNCs have become an engine of change through their injection of capital, technology, organizational skills, and a competitive environment. Foreign corporations not only bring with them new technologies and management systems, they also bring a different kind of corporate culture and new assumptions about

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the relations between a national government and a country's economic and sociopolitical institutions. At the same time, national control over a country's economic and sociopolitical arena is constantly being challenged, if not already considerably eroded.

Advocates of globalization point to increases in wealth creation in all parts of the world following moves toward open markets since the 1970s. They point to the increase in merchandise exports from developing countries, both in absolute terms and in percentage terms of their gross domestic product (GDP). Developing countries have witnessed large inflows of capital and technology, and have recorded high rates of GDP growth. Trade liberalization (read globalization) has been inextricably linked with a country's economic reforms and growth in GDP.[3] This has been evident in the economic growth of the Asian Tigers like South Korea, Taiwan, and Hong Kong since the 1970s, and more recently in the cases of China and India.[4]

There is evidence of strong linkage between participation in international trade and domestic economic growth. In "The Promise and Pains of Globalization," Dennis Rondinelli and Jack Behrman state that between 1960 and the early 1990s, the economies of countries that exported only a small proportion of their output grew less than 3 percent a year, compared with growth rates of 5 to 7 percent a year for countries exporting a large proportion of their output.[5] Economist Murray Weidenbaum asserts that globalization has been singularly successful in reducing poverty in the world.[6] The number of people in abject poverty in East Asia, living on less than $1 a day, has been reduced from 450 million to 280 million between 1990 and 1998. "Wars, natural disasters, totalitarian governments, pervasive corruption, mismanagement and anarchy must share the blame for the remaining abysmal poverty."[7]

Globalization has also contributed to substantial economic progress in the United States. For example, between 1993 and 1998, the real income of the poorest 20 percent of families increased at an average of 2.7 percent a year, while the top 20 percent averaged gains of 2.4 percent annually.[8] We are also told that evidence all around the world shows that economic freedom equates with higher living standards. In 1997, for example, the per capita income of the most economically free nations averaged over $18,000 against $1,700 for the least free.[9]

It should be pointed out that the current wave of globalization is neither the first nor the largest. The world has witnessed at least five prior waves of globalization: in the United States (1870–1890), Western Europe (1890–1913), Japan (1913–1938), the United States (1970), and

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Western Europe (1950–1992).[10] Most of these waves eventually petered out because of their adverse impact on the social infrastructure of the countries involved. Most notably, these adverse impacts were related to increasing income disparities and unequal sharing of gains from globalization between countries and among different groups within individual countries. Another adverse impact was felt by the poorest segments due to the dismantling and dislocation of the "social safety net," which resulted from changes in income distribution and government reallocation of social expenditures.

The proponents of globalization cite data on economic growth to support their case for even greater globalization. Unfortunately, these numbers do not tell the entire story. The benefits of globalization are greatly exaggerated by its proponents, who tend to ignore or understate many, if not all, of its adverse consequences. As Jeffrey Sachs and Andrew Warner point out:

> Long-held judgments about the development process, as well as the workhorse formal models of economic growth suggest that the poorer countries should tend to grow more rapidly than richer countries and therefore should close the proportionate income gap over time. The main reason for expecting economic convergence is that the poorer countries can import capital and modern technologies from the wealthier countries, and thereby reap the "advantage of backwardness." Yet in recent decades, there has been no overall tendency for the poorer countries to catch up or converge with the richer countries.[11]

Globalization and economic growth have had adverse side effects. Distribution of gains from international trade and investment has been highly skewed in favor of those who control the capital and against those who contribute human labor, especially in the developing countries. According to the World Bank, the disparity between rich and poor countries has grown 10 times wider during the past 30 years.

The number of people living on less than $1 a day may have been reduced by over 60 percent in an eight-year period, but it should be clear that the 1998 $1 is grossly decimated by inflation. Moreover, the current prevailing rate of $1.50 to $2 per day for 10-hour days, worked by most low-skilled and unskilled workers in Asian and Latin American countries, can hardly be called progress when one realizes the abysmally unsafe working conditions under which these workers toil to earn what we euphemistically call "a living."

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The poorest 20 percent in the United States may be increasing their earnings at a rate of 2.7 percent compared with the 2.4 percent rate of increase earned by the wealthiest. This is not progress but a statistical artifact. Income growth from $1 to $2 a day would be a 100 percent increase while income growth of $200,000 when income was already $1 million would be 20 percent or just a fifth as much. It is disingenuous to claim progress by showing a percentage increase over a small base, while the actual disparity in income between the poor and rich has actually widened. Similarly, although the average "economically free" person may be earning $18,000 per year, this figure does not say anything about the political freedom of people in economically free nations. Nor does it say anything about how the income is distributed among the richer and poorer segments of the population in these countries.[12]

In their overseas operations, MNCs have ensured that products made for them in developing countries meet quality standards acceptable to consumers in the industrially advanced countries. However, when it comes to workers and working conditions, MNCs have been indifferent, if not downright negligent, about ensuring the health and welfare of the workers who make those products. Consequently, we are finding widespread worker exploitation and abuse, and harm to the environment.[13]

As globalization has progressed, political boundaries have blurred, and the control of national governments in the domestic arena has diminished. Both the governments of industrially advanced countries and multinational corporations have sought to exploit this weakness to promote their own goals. The governments of the industrially advanced countries have essentially used their influence to protect the interests of MNCs based in their home countries as these companies expand their business activities abroad.[14] MNCs and the governments of industrially advanced countries have asserted, albeit gratuitously, that the greater expansion of international trade and economic growth will lead to a fostering of democratic institutions and improvement in the human rights records of developing countries where authoritarian and totalitarian regimes currently hold sway.

Such assertions are made almost as truisms. Yet they are actually untenable. America's trade with China has risen sixfold in the past 10 years and now stands at $85 billion. In the same period, U.S. investments there grew to $56 billion from $32 billion. Yet one would be hard-pressed to find commensurate gains in democratic institutions or human rights in China.[15]

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The irony is that in their home countries, multinationals depend on democratic systems of governance, the rule of law, and open societies to protect their interests and enable them to thrive. At the same time, they make enormous gains in countries where authoritarian and nondemocratic regimes deliver on the promise of disciplined labor, low wages, and lax controls on environmental protection and human rights. Thus, they seek to protect the gains of their exploitation in developing countries under the umbrella of their home country's democratic institutions.

The advocates of limitless globalization emphasize its role in economic growth and development around the world. The drive toward globalization is also linked with the rise of the private sector as if government per se was a prime detriment to a nation's economic growth and the prosperity of its people. That any constraints on the markets were per se constraints on economic growth and individual freedoms is, however, a very narrow construction of the social role of capitalism in general and corporations in particular. The market system is not a perfect mechanism. It requires a certain degree of state supervision to enforce the rules of the game. Moreover, as Irving Kristol observes, historically the virtue of capitalism was measured (1) in terms of its ability to maximize production of goods and services and provide people with maximum freedom to pursue their self-interest, and (2) to create a distributive system of social rewards and benefits that people considered just, fair, and equitable. Kristol suggests that modern defenders of capitalism have been emphasizing the former, while the survival of the system depends on the public's perception of capitalism's ability to deliver the latter. Devoid of its moral and aesthetic core, capitalism would be likely to lose its ethical mooring and social legitimacy.[16]

## Multinational Corporations and Globalization—A Case of Neomercantilism

For the benefits of free trade to be distributed equitably, it is important that both capital and labor have maximum mobility, thereby allowing each party to maximize the reward from its efforts. However, in the new scheme of things, MNCs have all the advantages of moving capital between different sectors and nations in order to maximize their return on investment. Workers, on other hand, are disadvantaged because they lack

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such mobility. Workers in a country cannot easily migrate, if at all, to another country with labor shortages and thus bring about a better balance of supply and demand.

This situation is more akin to neomercantilism than to free trade. Multinationals use the threat of capital mobility to extract the maximum share of productivity gains from cheap and abundant labor. Unable to reduce supply through emigration, local workers compete with each other for available jobs, reducing their wages to subsistence level. At this level, wages may prevent starvation, but they do not allow for savings to be invested in the human capital of the current workers or future generations. Otherwise, how could one explain the fact that the minimum hourly wage rates are $5.15 per hour in the United States while they are less than U.S. $0.30 per hour in most developing countries, with essentially similar—and often higher—productivity levels in developing countries.[17] Given the large wage gap and similar or higher productivity rates, workers in Asian countries—other things being equal—should be able to extract somewhat higher wages and reduce the disparity between wage rates. However, their lack of bargaining power condemns these workers to work for subsistence wage rates and "be grateful for it."

This neomercantilism creates a monopoly-like condition in favor of MNCs and enables them to hire workers at subsistence-level wages. MNCs maintain their control on wage rates in several ways: (1) the MNCs minutely scrutinize the cost structure of local manufacturers, to enforce cost controls; (2) local manufacturers cooperate among themselves by not competing for workers on the basis of higher wages—a situation that is easily maintained because of abundant labor; (3) most workers come from rural areas to seek employment and are unaware of their rights under local laws; (4) labor authorities—induced by corruption and the need to protect their tax base—often collude with local manufacturers to violate even the rudimentary labor laws pertaining to minimum wages and working hours; and, finally, (5) the MNCs' power over local wages and working conditions becomes almost absolute because these MNCs control access to foreign markets through ownership of brand names, technical know-how, and supply chains.

An abundance of cheap labor leaves little incentive for MNCs to improve technology and thereby labor productivity. MNCs further exacerbate this situation through outsourcing most, if not all, of their production needs to local entrepreneurs. It is the predominant mode of operation by most MNCs in the poorer and developing countries of Asia, Latin America, and

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now Eastern Europe. This process places the entire burden of providing capital on local entrepreneurs. Available empirical data suggest that local entrepreneurs in developing countries have a short-term perspective on investment, enterprise growth, and profitability. Lacking capital and technology, these entrepreneurs resort to further exploitation of labor through long working hours, often without payment of overtime, and under dangerous and unhealthy working conditions.

The developing country is faced with a Hobson's choice of exporting at any cost or dying because of lack of foreign exchange and foreign capital. This dilemma "conveniently leaves out why a country exports in the first place: to favor the development of the internal market, which is another way of saying the collective well-being of society."[18]

The manifestation of the current forces of globalization creates fewer opportunities for a multiplier effect and backward transformation of physical, social, and economic infrastructure that would provide the developing country with the wherewithal for economic takeoff and sustained growth. "It benefits some people and modernizes some things, while excluding the bulk of the population, offering them only the fantasy that owning a cellular telephone will make them part of the new world order."[19]

The mobility of capital means that an important segment of the local governments' tax base can simply get up and leave, giving governments the unappetizing option of imposing disproportionately high taxes on income from labor,[20] agricultural products from even poorer rural areas, and household consumption, and higher taxes on local property. Short of resources, host country governments have been unwilling or unable to exercise regulatory oversight to enforce the already rudimentary infrastructure of labor and environmental protection laws.

Globalization and the dominant role of MNCs do not provide any mechanisms to enhance a country's economic infrastructure and instead push lower its already meager fiscal resources through tax abatement, tax holidays, and other esoteric techniques. Lest we forget, the growth of the industrialized nations was not achieved by private enterprise alone. Even in the United States, it was the government that created the vast state-supported educational infrastructure and the highly subsidized railroads that helped educate the populace and improved transportation systems.

Control of final product and distribution channels by MNCs leads to greater standardization in manufacturing processes, which emphasize use

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of labor over capital. This in turn leads to commoditization of labor and allows MNCs to shift production among suppliers in different countries in a seamless manner. It puts an added burden on manufacturers in one country to harmonize their production costs—in dollar terms regardless of different local conditions—to compete with manufacturers in other countries. An inevitable consequence of this process is that workers in one poor country must now compete with workers in other poor countries. This situation works to the advantage of MNCs by further depressing marginal wage rates because of the vastly expanded labor pool. Finally, subsistence-level wage rates propel rural families to produce more children to work in the factories, in order to sustain the family, which creates a self-perpetuating cycle of poverty.[21]

This situation is further compounded by the fact that most manufacturing operations primarily hire young workers between the ages of 16 and 18—except in high-skill areas—and do not keep them beyond the ages of 20 or 21, only to replace them with another wave of 16- to 18-year-old workers. The older workers, with few additional skills, are then thrown out to join the armies of the destitute and unemployed.

One must also add to this developing situation the impact of public interest groups, or nongovernmental organizations (NGOs) in the United Nations parlance, in the United States and other industrially advanced countries. These NGOs come from a variety of sources and include religious institutions, environmental groups, human rights organizations, organized labor, groups dealing in issues of public health, and groups concerned with global poverty, to name a few. NGOs have sought to hold multinational corporations accountable for the negative impact of their activities in developing countries. They have used mass media, direct action, governmental lobbying, and other forms of public and private pressure to force corporations to become more accountable. Avenues of protest have been the exposure and denunciation of corporations in the media, consumer boycotts, and other forms of pressure campaigns to embarrass the offending corporations. In the process, NGOs have brought these issues into the public forum and raised people's awareness of the need to seek greater accountability from MNCs in their overseas operations. There is every reason to believe that NGO activism is here to stay and will have an important role in most future deliberations on global economic, environmental, and human rights issues. Conflicts between market economies and democratic societies are not generally about aggregate economic growth or the activities of private

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sector institutions. Instead, the debate on business-society conflicts must be formed in broader terms, that is, the nature of public-collective goods and private goods. The former are viewed as society's endowments to be shared by all of its members without regard to one's ability to pay for them. The distributive criteria are those of need, social relevance, and collective enjoyment. Private goods are for the exclusive enjoyment of their owners and, within broad limits, to be bought, sold, and exchanged at their owners' discretion. Expansion of market activities, by its very nature, creates more private goods, often contracting the supply of public goods. While business institutions are applauded for their production of private goods and services, they also take the major blame for depleting the stock of public goods.

In one sense, society's moral and ethical values, concern for the less fortunate, and preservation of the natural environment are public or collective goods. All members of a society stand to benefit from an enhancement of these values regardless of their individual contributions to such enhancement. Here the nature of corporate mission and goals and those of private voluntary organizations stand in sharp contrast. This may partially explain the inherent discrepancy in public trust and goodwill enjoyed by public interest groups compared to the business community.[22]

The collective stock of a society's moral and ethical values will increase if more and more individuals and groups behave with a greater degree of altruism. In the case of public interest groups or NGOs, there is a presumption of altruism, which is further strengthened by their espoused missions and goals. Even when individual NGOs act in a manner that could be construed as antisocial in some quarters, they are still viewed as only hurting private greed for larger social good. The problem of a free rider—that is, one who takes a greater share of public-collective goods without adequately contributing to the enhancement of their stock or being concerned about depriving others of similar enjoyment—is not considered serious. NGOs are expected to behave in the public interest. It is their raison d'être. Ergo, there is no free rider.

MNCs, as private sector institutions, face the exactly opposite problem. They must always try to maximize gain by internalizing all possible profits and externalizing all possible costs. Given competitive markets, firms have a great deal to lose from contributing to general public trust and moral and ethical values and everything to gain from being a free rider. Since a firm cannot control the behavior of other firms, it must assume that other firms

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would behave equally aggressively as free riders. The exception to this rule would take place under conditions of imperfect markets, that is, where a firm is anxious to protect its strong market position and resultant nonmarket rent or above-normal profits by courting the goodwill of its customers, government regulators, or public at large.[23] The incentive to do so, however, is not altruism but a desire to preserve the firm's extra profits. Thus public goodwill is measured by its direct costs in terms of loss of potential profits. Both these conditions tend to undermine the value of business contributions to enhancing a society's ethical and moral values because companies are viewed to be primarily acting in self-interest, thereby discounting their claims of being good public citizens.

It is not now, and unlikely to be in the foreseeable future, that the traditional role of competitive markets, and corporations as their primary institutions, will be supplanted by other institutions in most democratic and industrially advanced societies. If anything, this role is gaining wider acceptance in other societies that had previously denigrated it or chosen to follow the path of a centrally managed, government-controlled system of economic growth.

The areas of conflict rest almost entirely on the means that business institutions allegedly use to circumvent the discipline of markets or to appropriate for their use gains from the marketplace arising out of their superior bargaining leverage, insufficient consumer information, and a host of other factors classified under the economic concept of "market failures" or "market imperfections." And yet MNCs rarely if ever address issues of social conflict or their adversaries along those dimensions until such time that an issue has reached crisis proportions with pressure from people and other institutions of society for companies to curb their behavior and provide greater accountability and justification for the harm that they have caused to noneconomic institutions of society.

The future challenge to globalization and the role of MNCs will not come from the opponents of free trade and economic growth. It will arise from the inability and unwillingness of multinational corporations to voluntarily act in a socially responsible manner, and their unwillingness to be accountable, and transparent, for the second-order negative consequences of their wealth-creating activities. The primary issue here is twofold: one, to ensure that economic growth is accompanied by a sense of fair distribution of gains from productivity between those who provide capital and those who provide labor; two, for MNCs to internalize more of the costs of appropriating public goods by using them more efficiently, and also by contributing to the increase in the stock of public goods.

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# Notes

1. Jagdish Bhagwati, *A Stream of Windows—Unsettling Reflections on Trade, Immigration, and Democracy* (Cambridge: MIT Press, 1998); Robert Baterson and Murray Weidenbaum, *The Pros and Cons of Globalization* (St. Louis: Center for the Study of American Business, Washington University, 2001), 22; "Globalization and Its Critics," *The Economist* (September 29, 2001), 30.
2. Jeffrey Sachs and Andrew Warner, "Economic Reform and Process of Global Integration," *Brookings Papers on Economic Activity* No. 1 (1995), 1–118.
3. Ibid.
4. S. P. Sethi and B. B. Bhalla, "Free Market Orientation and Economic Growth: Some Lessons for Developing Countries," *Business and the Contemporary World* 3:2 (Winter 1991), 86–101; S. P. Sethi, "Human Rights and Corporate Sense," *Far Eastern Economic Review* (October 19, 2000), 37; S. P. Sethi and B. B. Bhalla, "The Peril to the Global Environment: The Role of Globalism," *Business and the Contemporary World* (Autumn 1991), 114–125.
5. Dennis Rondinelli and Jack Behrman, "The Promise and Pains of Globalization," *Global Focus* 12:1 (2000), 6 (cited in Murray Weidenbaum, *Looking for Common Ground on U.S. Trade Policy* (Washington, D.C.: CSIS Report, August 2001), 6).
6. Weidenbaum, *Common Ground*, 6.
7. "World Development Indicators 2000" (Washington, D.C.: World Bank, 2000), Tables 4.10 and 4.11 (cited in Weidenbaum, *Common Ground*, 6).
8. John M. Berry, "This Time, Boom Benefits the Poor," *Washington Post* (February 14, 2000), C5 (cited in Weidenbaum, *Common Ground*, 6).
9. James Gwartney and Robert Lawson, *Economic Freedom of the World: 2000 Annual Report* (Vancouver: Fraser Institute, 2000), 15 (cited in Weidenbaum, *Common Ground*, 6).
10. Dani Rodrik, *Has Globalization Gone Too Far?* (Washington, D.C.: Institute for International Economics, 1997), 7. The current phase of globalization benefits mostly industrialized nations and a small set of developing countries in Asia. It excludes most of Africa and large parts of Latin America. These and other countries in Eastern Europe and other parts of the world have been left to their own devices to find a way to become part of the new world. The choice of which countries shall benefit from globalization is a function of the needs of MNCs in industrially advanced countries, and has little to do with the needs or the potential of developing countries. Thus we are faced with the phenomenon of an expanding disparity between the richer and the poorer countries, and also between the richer and poorer people in individual countries.
11. Sachs and Warner, "Economic Reform," 1–118.

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12. S. P. Sethi, Joel Kurtzman, and B. B. Bhalla, "The Paradox of Economic Globalism: The Myth and Reality of the 'Global Village'—The Changing Role of Multinational Corporations," *Business and the Contemporary World* 6:4 (1994), 131–142.
13. "Global Capitalism: Can It Be Made Better?" *Business Week* (November 6, 2000), 72–90; "Take a Break, Trade Bullies," *Business Week* (November 6, 2000), 100–101; S. P. Sethi, "Human Rights and Corporate Sense," *Far Eastern Economic Review* (October 19, 2000), 37.
14. Fareed Zakaria, "Globalization Grows Up and Gets Political," *New York Times* (December 31, 2000), 24.
15. Sethi, "Human Rights and Corporate Sense," 37, note 13.
16. Irving Kristol, "When Virtue Loses All Her Loveliness: Some Reflections on Capitalism and the Free Society," *Public Interest* (Fall 1970), 3–16.
17. After more than 18 years of observing manufacturing operations in many developing countries, I have seen the truth in the notion that worker productivity in low-skilled and comparatively less capital-intensive manufacturing operations is considerably higher in developing countries. A large part of this productivity comes from long working hours and high production speeds. This also accounts for the fact that relatively young workers, 16 to 18 years old, perform most of these operations. The fact that such long hours and high manufacturing speeds lead to exhaustion, worker injury, and long-term health damage rarely enters into employers' considerations.
18. Oscar Ugarteche, *The False Dilemma: Globalization, Opportunity or Threat* (New York: Zed Books, 1997), xiii–xiv.
19. Ibid. xiv.
20. Rodrik, *Has Globalization Gone Too Far?*, 6.
21. Daniel Cohen has made a similar argument with respect to the use of women as beasts of burden in Africa. See Daniel Cohen, *The Wealth of the World and the Poverty of Nations* (Cambridge: MIT Press, 1998), 7.
22. In developing these ideas, I have greatly benefited from the writing of Fred Hirsch, *Social Limits to Growth* (Cambridge: Harvard University Press, 1976). See in particular Section II, "The Commercialization Bias," pp. 72–114, and Section III, "The Depleting Moral Legacy," pp. 117–158.
23. William Baumol, *Perfect Markets and Easy Virtue* (Cambridge, Mass.: Blackwell, 1991); Thomas Schelling, *Micromotives and Macrobehavior* (New York: W. W. Norton & Co., 1978), 9–45. See also Amartya Sen, "Behavior and the Concept of Preference," *Economica* (August 1973), cited in Hirsch, *Social Limits*, 139; and Robert H. Scott, "Avarice, Altruism, and Second Party Preferences," *Quarterly Journal of Economics* (February 1972), cited in Hirsch, *Social Limits*, 78.