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Inquiry into the institutions and governance of globalization

Testimony of the Director General of the Bank of Italy
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Mr. Chairman, honourable members, it is a great honour for me to be asked to take part in this series of hearings on globalization and, in particular, on the governance of the globalized economy.

Before going into the merits of the question, it is necessary as a premise, to my mind, to review briefly the phenomena that characterize the present phase in world economic integration with respect to the past and its effects on growth and welfare in the different regions of the world.

1. The nature and origins of globalization

The word "globalization" is used to designate the process that in the last twenty or thirty years has led to the opening and integration of the markets for goods, capital, labour and technological innovation, involving broader and broader sections of the world economy. This process has been accompanied by another phenomenon of worldwide import, which was in part a precondition for it: namely, the revolution in information and communications technology. The combination of these two events has brought radical transformations in the mode of production and exchange within the advanced economies as well.

The current period of globalization differs from the analogous period that stretched from the mid-19th century to the outbreak of the First World War in one

fundamental way: that earlier process was triggered by the plunging cost of transportation of goods and people, made possible by scientific discoveries and technical advances; the present globalization was triggered by the reduction in the cost of intangible transmission of information, again thanks to technical progress. That is, in the globalization of the *belle époque* it was goods and people that increased their international mobility enormously; now, even more than goods, capital and people, it is ideas, knowledge and individual skills that move at a dizzying pace.

Another factor sets the current situation apart from that of a century ago. Whereas a hundred years ago the barriers to the international movement of goods, capital and persons were practically non-existent, or at any rate very low, today tariff and other restrictions – introduced during the phase of protectionism between the two world wars and only partially dismantled afterwards – still impede the free circulation of goods in many parts of the world, especially in the developing countries. The industrial countries have lowered their customs duties on goods imports considerably (to an overall average of 3 per cent) but they still apply high tariffs to some imports from the developing countries that are essential products for the latter. Further, although agriculture now plays a practically negligible role in their overall economies, the advanced countries continue to protect farm products by measures that are costly both for domestic consumers and for the producers of those products in the poor countries.

These barriers notwithstanding, the potential for international economic integration is great indeed. The range of goods, services and financial investments available on the world market, including on a remote basis, has increased enormously. The geographical frame of reference too has been revolutionized, with

a shift of the central axis towards Asia. Finally, the multilateral institutions assigned to safeguard international trade and finance are now very highly developed and capable of dealing with the new challenges.

2. The data

2.1 World trade flows

The average annual growth rate of world trade in goods and services rose to 6.4 per cent in the 1990s, twice that of world output (Table 1 and Figure 1). In the current decade world trade has accelerated further to expansion of nearly 7 per cent per year, and world output to 4.3 per cent. A considerable impulse was imparted by the expansion of trade in the emerging areas, whose imports are estimated to have accounted for more than a third of the total growth in world trade.

The internationalization of production processes and the spread of technology benefited the emerging economies located closest to the main outlet markets of the US and the European Union, such as Mexico and the countries of central and eastern Europe; they have also favoured the economies of Asia with their low labour costs but relatively skilled human capital. The emerging countries' share of world manufactures exports, which had held steady through the 1980s at around 20 per cent, rose to 32 per cent in 2005. China's share reached 10 per cent, about the same as that of the United States (Table 2).

The degree of the competitive pressure that the emerging countries exerted on the industrial ones varied from sector to sector. At first competition was concentrated in the mature consumer goods industries, where unskilled labour is more intensive and large-scale investment in physical plant and technological innovation is not required. In 2003 some 35 per cent of the emerging countries' exports of manufactures involved mature consumer goods, and more than half of that consisted in clothing and textiles (Table 3). The industrial countries fought the penetration of their markets by concentrating their residual trade barriers in these sectors, and not until 2005 was the system of import quotas – the Multifibre Agreement – completely dismantled, after having limited the expansion of clothing and textile imports from Asia for more than thirty years.

In the 1990s the competition was extended also to more capital-intensive industries of medium and high technological content. In motor vehicles and other mechanical engineering sectors the emerging countries' share of the industrial countries' market rose from 11 per cent in 1990 to 26 per cent in 2002. Electronics and telecommunications now account for 36 per cent of these countries' exports, compared with 26 per cent in 1990.

In response to this evolution in world trade specialization, output and employment in the industrial countries shifted towards technologically advanced sectors using more highly skilled labour. The share of medium- and high-tech products in their total manufacturing exports rose to 70 per cent. In the last decade the EU countries have modified their specialization model, bringing it more into line with those of the US and Japan. The process has differed from country to country, however; Italy, in particular, has accumulated lags in adapting its productive specialization to the new challenges of global competition.

International economic integration, which has increased by leaps and bounds in manufacturing, remains scant in agriculture, owing to the severe trade barriers still in place even in the industrial countries in the form of customs tariffs, quotas and domestic farm subsidies. These barriers survived the Uruguay Round of multilateral trade liberalization concluded in 1994, and their reduction is a highly controversial issue in the current Doha Round as well.

Integration between emerging and developing countries has proceeded more haltingly, owing to barriers to protect inefficient domestic industries against competition from other countries with low costs. A major exception is represented by the economies of Asia, where integration in trade in manufactures has increased notably in the last fifteen years; indeed, intra-regional trade now accounts for nearly 50 per cent of these countries' total foreign trade. The region has developed its own, highly integrated supply chain, in which China is playing an increasingly important role.

To sum up, the last decade and a half has seen the extremely rapid expansion of world trade and a significant redirection of trade flows, with the emerging and developing countries playing an increasingly important role on the global stage.

2.2 Migratory flows

Globalization has also affected the labour market. In the 1970s and 1980s, with the widening welfare gap between rich and poor countries, the migratory flow from the latter to the former increased. According to UN estimates, in the second

half of the 1990s these inflows, net of repatriations, came to 13 million persons. Underestimated though it probably is by the official statistics, this number is in any case quite low considering the disparity in per capita incomes between advanced and emerging countries. It is also low historically compared with the enormous waves of migration of the 19th and early 20th centuries. OECD studies have found that the increase in emigration in recent years has mainly involved relatively well-educated persons, confirming that the decision to leave one's home country is affected not only by income but also by the real likelihood of building a better life in the new country, which is clearly correlated with the level of education. Immigration to Italy (300,000 persons a year between 2000 and 2004 according to the OECD) is still significantly less than to Germany, the United Kingdom and Spain. Although the share of the Italian resident population accounted for by immigrants rose rapidly from 2 per cent in the mid-1990s to 2.9 per cent at the start of the new decade, it remains smaller than in the other large European countries (Table 4).

By comparison with trends in merchandise trade, then, we can say that the mobility of people, though increasing, remains limited, in part owing to the barriers against immigration that the advanced countries have retained.

2.3 Capital flows

Since the turn of the 1990s the liberalization of financial markets and the complete removal of controls (including those in Europe) on international capital movements have triggered an extraordinary growth in cross-border financial flows.

In the emerging regions financial opening has been more gradual. Administrative controls on flows of the most liquid forms of capital have been retained. Since the mid-1990s financial and foreign exchange crises have struck Mexico, some Asian countries, Russia, Brazil, Turkey and Argentina, temporarily halting the process of financial integration. Market integration itself, in these circumstances, may amplify disturbances and make their spread faster not only within a region but also between countries in different regions, relatively non-integrated and at different levels of development.

The industrial countries' gross external financial assets and liabilities nearly tripled in proportion to GDP between 1992 and 2004, reaching 320 per cent. At the same time the propensity to invest in domestic securities diminished. Notwithstanding numerous regulatory restrictions on international capital movements, in the emerging countries too there was intensive financial integration with the rest of the world. Between the end of the 1980s and 2004 the stocks of these countries' external financial assets and liabilities increased nearly fourfold to 160 per cent of GDP (Figure 2).

Net flows of private capital to the emerging countries are estimated by the IMF at $225 billion a year in 2005 and 2006 (Table 5). The recovery following the crises of the 1990s was fuelled by the good prospects for economic growth in these countries, attributable not only to the strong performance of the world economy but also to progress in macroeconomic policies: reduction of government budget deficits, control of inflation, and enhanced credibility of monetary policy.

The expansion of financial flows since the start of the 1990s has been extraordinary but discontinuous, with a good number of episodes of market

disorder and national financial crises. The latter proved to be costly for the countries involved in terms of losses of output and employment. Nevertheless, it should be pointed out, these more recent crises were much briefer than those of the 1980s.

2.4 Foreign direct investment and the transfer of knowledge

A special class of international capital movement is foreign direct investment (FDI). Driven not by purely financial motivations but by an interest in productive activity, FDI consists in the purchase of equity stakes in companies located in foreign countries or in the construction of a production plant abroad. Such investment implies the foreign investor's direct involvement in the management of the productive or commercial activities acquired and ordinarily entails the transfer not only of financial resources but also of technology and organizational and managerial resources from the home country. In 1985 the total stock of FDI was equal to just 7 per cent of world GDP; now it comes to 23 per cent (Table 6). A major stimulus to FDI has come from new technology, which permits the distance control of production and its fragmentation into separate stages executed in different locations, so as to exploit cost differences between countries while still enjoying economies of scale.

Together with trade in capital goods and intermediate inputs, FDI is a major indirect channel for the diffusion of technological innovation from the advanced to the less developed countries. A direct channel of technology transfer, used largely by firms belonging to multinational groups or having agreements for international technological cooperation, is production under licence and concession for the

exploitation of innovations. In the last twenty years the international knowledge market too has grown significantly, with a thirteen-fold increase in the value of cross-border royalties and licences. Initially limited to the advanced countries, this market has become accessible to residents of the emerging or developing countries, which now account for a 13 per cent share. The production of innovation itself (R&D) is also being relocated internationally. UNCTAD estimates that some 16 per cent of private R&D expenditure in the world is now accounted for by the foreign affiliates of multinational corporations, compared with 11 per cent ten years ago. This has enabled a number of emerging Asian countries, notably South Korea and Taiwan, to develop a significant autonomous capability for innovation.

The multinationals are often blamed for the persistence of the enormous disparities in income between rich and poor countries. This assertion is misleading. Both historical and economic analysis show that the factors underlying poverty and the failed economic takeoff in some countries and regions are so complex and deep-rooted that tracing them to the "misconduct" of a few corporations is simplistic. On the contrary, the multinationals can help trigger rapid economic growth, as is demonstrated by the experience of the emerging countries of Asia, especially China. To make this positive outcome possible, not only must the multinationals fully obey the laws and regulations of the "host" countries but local governments must monitor them closely; which brings up the thorny, complicated problem of the deficit of democracy and the high level of corruption in many developing countries.

3. The main effects of globalization

3.1 Growth and welfare

Since the turn of the 1990s, and especially in the last few years, the growth of the world economy has been powered largely by that of the emerging Asian countries. In the current decade, for the first time since the 1970s, per capita income has grown faster in the poor and middle-income countries than in the rich countries (4 as against 2 per cent per year).

In the first half of the decade per capita income in the emerging areas of Eastern Asia rose by over 7 per cent per year (Figure 3); the rate in China has been between 8 and 9 per cent. In two decades half a billion people have liberated themselves from extreme indigence. In India, growth accelerated to 5 per cent a year in the mid-1990s, when economic liberalization measures were stepped up. The trend in per capita income turned positive again in Latin America in the 1990s, and in the current decade the annual rate of increase has risen to 1.5 per cent. Even in sub-Saharan Africa per capita income has resumed stable growth, at 2 per cent per year, since 2000, albeit starting from extremely low levels.

The underlying causes of the differences in economic growth rates in the different emerging areas are complex. They stem from a set of historical and institutional factors that are hard to alter, especially in the short run. Economic analysis cannot take all these factors fully into account, but the many technically sophisticated empirical studies produced to date do show a positive correlation between globalization – defined as increased trade in goods, the mobility of capital and people and the spread of technological knowledge – and higher growth rates.

This result is robust both to cross-country comparison and to comparison of the economic performance of a given country before and after liberalization. By contrast, there is no evidence that countries closed to international exchanges of goods, capital, persons and technology have managed to achieve positive economic results in the long run.

3.2 Poverty and income inequality

In the last 25 years globalization has been accompanied by a reduction in world poverty, albeit not everywhere and not as much as hoped. The usual gauge of the improvement in living standards is the absolute poverty line, a level of subsistence income or consumption that is held constant in real terms over space and time. This level is conventionally set, in technical terms, at one international dollar a day. One yardstick of gains in reducing poverty is the share of the population below that line.

On this basis the poor population of the world shrank from 40.4 per cent in 1981 to 27.9 per cent in 1990 and 19.4 per cent in 2002 (Table 8). A major contribution came from the drastic reduction in poverty in China, from 64 to 14 per cent of the population. And over the same period even the actual number of people living below the absolute poverty line fell, from 1.5 billion to 1 billion. This constitutes an extremely impressive advance, considering that the population of the developing countries grew by 1.5 billion during the same years. But the incidence of poverty did not diminish evenly. It fell sharply throughout East Asia but declined much less in southern Asia, owing in part to rapid population growth, to 31.2 per cent in 2002. It fell only slightly in Latin America, to 8.9 per cent. And the rate

actually rose further, to 44 per cent, in sub-Saharan Africa. In that continent widespread poverty is associated with precarious health and hygiene conditions, reflected in very low life expectancy at birth (just 46 years, against an average of 65 in the low and middle income countries as a group), and low levels of education (Table 9).

During this same quarter-century of economic globalization and reduction in poverty, the inequality of income distribution both between countries and within many of them grew more acute. The income gap between the developing and the affluent countries widened. Per capita income in Latin America fell from 37 per cent of that of the advanced countries in 1980 to 26 per cent in 2004. In the Middle East and North Africa it fell from 22 to 19 per cent, and in sub-Saharan Africa from 11 to 6 per cent (Figure 4). Only Asia achieved a relative advance in living standards.

Such sharp differences in per capita income may exist alongside smaller differences in real living conditions, when account is taken of such factors as health, as reflected in life expectancy, and education. According to the United Nations, 80 per cent of the adult population in the developing world is now literate; the attendance rate of young people at all school levels averages 63 per cent (Table 9).

As to the distribution of income within countries, inequality has increased in many, most notably China and India. The degree of inequality in China is now exceeded only by that in Brazil and South Africa, the two countries with the most unequal distribution of personal income. The main causes are the worsening disparity in living standards between cities and countryside and between workers of

differing levels of education. Recent empirical studies have found no systematic causal link between economic growth in the emerging countries and the increase in inequality. Nor do the concomitant measures of economic liberalization appear, per se, to be the cause of increased inequality.

Within some of the leading industrial countries as well, the United States in particular, income disparities have tended to widen. In Italy, the inequality of household incomes worsened significantly in the early 1990s and stabilized in the following years, with only minor fluctuations. The degree of income inequality in Italy is among the highest of all the advanced countries, on a par with the other countries of southern Europe, Ireland and the United Kingdom.

Neither in Italy nor in the other advanced countries, however, can this tendency to greater income inequality be blamed solely on the opening of markets to the sharper competition induced by globalization. It is due above all to extremely rapid technological progress, whose severe repercussions on the labour market have not been compensated for by adequate public policies of income redistribution.

3.3 Risks of protectionism

The tensions caused by this income inequality have been partly behind calls in some industrial countries for protectionist measures against a few emerging economies, notably China. It is universally acknowledged in the literature that increased integration leads to increased collective welfare, while the erection of barriers to free trade in goods may easily trigger “reprisals” that are harmful to all.

The need to resume the multilateral free trade negotiations initiated in Doha in 2001 has already been mentioned in the course of this inquiry, in the testimony of Pascal Lamy, Director-General of the World Trade Organization. I will not dwell further on the subject. However, I do want to stress that a successful conclusion to the Doha talks would avert a perilous shift towards protectionism and would permit significantly stronger world economic growth in the long term as trade barriers are further dismantled in a context of clear and transparent rules. I am one with Mr. Lamy in asserting that balanced global growth is best served by a multilateral strategy. Should the Doha Round collapse, bilateral and regional trade agreements will continue to proliferate. Regional agreements in particular would be costly and inefficient from all points of view and, moreover, would exclude even more the poorest countries, with their unattractive markets and lack of bargaining power.

4. The role of the international institutions

The aims and methods of economic cooperation have been shaped by the development of highly integrated private financial markets, which took off in the 1990s. From the traditional confines of the macro economy and the coordination of economic policies and exchange rates, cooperation was extended to questions of market structure, regulation, banking supervision practices, and standards and codes of conduct in the financial sector. Agencies and organizations have sprouted in response to the need for a more efficient division of labour, involving private sector interests and players at various levels.

The two leading multilateral financial institutions, the International Monetary Fund and the World Bank, are the main channel through which the world community discusses and draws up solutions to the problems mentioned earlier. Italy contributes to establishing their guidelines not only by participating in the informal groups of leading member countries (G7, G20, Financial Stability Forum), but also directly, through the positions taken by its Executive Director on the respective Boards.

Here I will consider the IMF at greater length, as its functions and mission closely resemble those of a central bank.

4.1 International Monetary Fund and World Bank: organization, functions and future

As new nations emerged with decolonization and later with the collapse of the Soviet Union, membership of the IMF and the World Bank was enlarged from the original 40 countries to the present 185. There are profound differences between the two institutions, mainly relating to their "missions" and their methods of operation. The primary responsibility of the IMF is still to promote *macroeconomic stability* of the member countries, while functions connected with the *growth and structure of the less developed economies* are attributed mainly to the World Bank. These different missions imply different operational structures and methods of action.

The traditional functions of the IMF (surveillance, financial support and technical assistance) have changed considerably over the years. Until the beginning

of the 1970s the IMF was the “guardian” of an international monetary system based on fixed but flexible exchange rates and capital movements of modest dimensions and restricted by a system of administrative controls. In this context, the purpose of surveillance was to identify economic policies consistent with the exchange rate system and oversee those actually adopted by the member countries, with power to impose heavy sanctions in the event of non-compliance. After the collapse of the fixed exchange rate system, countries were allowed to choose their own system subject to such generic requirements as the adoption of domestic policies “geared to stability” and the undertaking “not to manipulate” the exchange rate to the detriment of trade partners. Despite these weak legal foundations, the IMF has managed to adapt its activities to the circumstances of the member countries, exercising considerable influence over their economic policies. Following the financial crises of the late 1990s and the problems that arose mainly in the financial sector, surveillance was extended from the traditional sphere of macroeconomic policies to the adoption of standards and codes for the conduct of banking supervision, market rules, and transparency of statistical information.

In the case of low-income member countries, the Fund focused instead on their vulnerability to external shocks and associated economic stabilization policies. Cooperation with the World Bank on problems of poverty, growth and income distribution was stepped up. However, some confusion of roles arose and relations between the two institutions became strained. In recent years the IMF has sought increasingly to combat poverty through subsidized medium-term loans to the poorest countries with least access to the capital markets, while the Bank has operated structural adjustment programmes reaching well beyond its original mission of project financing.

The IMF's lending function continues to hinge on its structure as a "mutual bank". Basically, the capital subscribed by the member countries (their quotas) is used to grant loans to members with temporary balance of payments difficulties. The volume of outstanding loans to members fluctuated along a steadily rising trend until the beginning of this decade; the peaks in disbursements bear witness to the series of crises that overtook various groups of countries: first, the industrial nations, affected by the rise of oil prices in the 1970s, and then the emerging countries, overtaken by foreign debt crises in the 1980s and violent turbulence in capital movements, leading to the financial crises of the 1990s (Figure 5).

The World Bank, like the IMF, was also instituted at Bretton Woods in 1944 as a cooperative of nations. Its initial objective, to finance post-war reconstruction, has evolved over the years into a mission to reduce poverty and foster sustainable growth. Unlike the IMF, the Bank raises funds on the market by issuing debt securities. Its AAA rating allows it to raise funds at low cost and pass them onto the beneficiary countries at special conditions; its gross income serves only to cover operating costs, as it is non-profit-making.

The World Bank offers a wide range of products and services, not only credit but also consultancy and technical assistance, as well as providing financial support in the form of outright grants or soft loans through the International Development Association (IDA). This fund is re-capitalized periodically by the donor countries and run by the Bank's staff. Interventions are limited to the 82 poorest countries and are designed to foster economic growth, reduce inequality, and improve standards of living. Since its foundation the IDA has disbursed a total of $161 billion, of which around half to Africa.

4.2 New bodies: the Financial Stability Forum and the G20

The most significant innovation in the governance of the global financial system has been the creation of the Financial Stability Forum (FSF). It was set up in 1999 under the aegis of the G7 and is currently chaired by the Governor of the Bank of Italy. It brings together, within a single, informal framework, the governments, central banks and national supervisory authorities responsible for financial stability of the G7, plus Australia, the Netherlands, Hong Kong and Singapore. They are joined by representatives of the main international organizations (the IMF, the World Bank, the BIS and the OECD) and the self-regulatory organizations for the banking, corporate, insurance and accountancy sectors. The mandate of the FSF is (a) to assess factors of potential vulnerability in the world financial system; (b) to pinpoint the most effective means of tackling that vulnerability; and (c) to foster the coordination and exchange of information among the authorities responsible for financial stability.

In principle, the FSF focuses on the financial intermediaries and infrastructure, and not on individual countries; and on structural, financial and regulatory problems, rather than on cyclical, real and macroeconomic questions. Its ultimate purpose is to prevent crises. The potential causes of fragility that the FSF has addressed over the years include the role of off-shore centres, the operation of institutions with high financial leverage, the magnitude and variability of capital movements, the transfer of credit risk, the rules of corporate governance and, more recently, the activity of hedge funds.

Another important development has been the creation of a new, informal body, the Group of Twenty, which has gradually become one of the keystones of international cooperation. It is formed by the economic (or finance) ministries and central banks of the main developed and emerging countries, thus embodying virtually the entire world economy. This makes it a highly representative forum in which to discuss and reach consensus on the main issues of "global" economic policy: from the prices of raw materials and energy sources to migration; from the reform of multilateral financial institutions to action to combat poverty; and from protectionism to the social and distributive effects of globalization.

4.3 Poverty- and debt-reducing initiatives in the poorest countries

The international community's undertaking to combat poverty has recently been enshrined in more specific form in the Millennium Development Goals adopted by the UN General Assembly in 2000. The Goals, to be achieved by 2015, include halving the number of people living in extreme poverty, providing universal primary education, reducing child mortality, ensuring environmental sustainability and combating the main infectious diseases, such as AIDS, malaria and tuberculosis.

The strategy adopted to achieve the Goals involves, on the donor side, the advanced countries and the financial institutions (the IMF, the World Bank and the regional development banks) and, on the other side, the developing countries, which are called upon to make better use of aid through appropriate institutional reforms and enacting macroeconomic policies to ensure financial stability and better living conditions for the poor.

The poor countries still have a long way to go before these Goals are achieved. According to the latest estimates, the only Goal that can be achieved by the target date is the reduction of poverty: the proportion of people living in extreme poverty, i.e. on less than $1 a day, should decrease to 10 per cent in 2015, less than half the figure in 1990. The outlook is not as encouraging on the other fronts, the "human development" Goals. The gap is particularly wide in two regions, Southern Asia and above all sub-Saharan Africa.

Official aid from the industrial to the developing countries totalled $107 billion in 2005, equal to 0.33 per cent of the donors' GDP. This represents an increase of 32 per cent in real terms with respect to 2004. Most of the increase is the result of debt cancellation (particularly in the case of Iraq and Nigeria) and, to a smaller extent, of emergency aid; the flow of funds to finance development projects increased by 8.6 per cent (again, the largest amount has gone to two countries, Afghanistan and Iraq).

In 2006 and 2007, with less debt to cancel it will be difficult to ensure that the flow of development finance continues to rise. The objective for every donor country is to allocate 0.7 per cent of GDP by 2015. Making good on these commitments will require an enormous effort, particularly for the countries with especially tight balance-of-payments constraints or a modest volume of official development aid. Italy is among them; it provided $5.1 billion worth of aid in 2005, equal to 0.29 per cent of its GDP.

5. Problems and prospects of international cooperation

The main multilateral organizations are now in the throes of an identity crisis, caused, paradoxically, by the favourable world economic conditions and the absence of financial crises.

The outstanding loans of the International Monetary Fund have fallen, in absolute value, to the level of the beginning of the 1980s (Figure 5). On the other hand, in recent years the emerging countries, particularly those with persistent current account surpluses, have amassed huge foreign currency reserves, now equal to about ten times the IMF's financial resources. There is no lack of proposal, notably by the Asian countries, to use part of those reserves to set up new "regional monetary funds" that would grant loans like the IMF. Should the decrease in lending prove permanent (and should there no longer be an objective need for IMF assistance), that function would be dramatically reduced. Surveillance would need to be reformed, since the IMF's influence over countries depends partly on its role as potential lender.

The causes of the decline in IMF financing are partly structural and partly cyclical. The structural factors include better economic policies in member countries and the ability of private financial markets to meet the demand for credit. On the cyclical side, however, it cannot be ruled out that the present favourable phase may come to a halt. If that were to happen, sudden movements in exchange rates and interest rates and increases in the risk premium might alter the favourable financial conditions in the emerging countries, triggering turbulence that would damage the poorest countries as well. IMF financing might then pick up.

So, it is not a question of eliminating the Fund from the world institutional arena, or of reducing its role, but of adapting it to the conditions of a more complex global economy. The reform involves two aspects, IMF surveillance and the legitimization of the Fund as such. Surveillance is central to the activity of the Fund, above all because of the urgent need to reduce balance of payments disequilibria. The external deficit of the US has grown to considerable proportions – $850 billion, equal to 6.5 per cent of its GDP. Correspondingly, the leading Asian economies and the oil-exporting countries have recorded increasingly large surpluses. These imbalances cannot last indefinitely; there is the danger, should international investors no longer be willing to finance the US deficit, that adjustment will prove traumatic. The IMF has therefore instituted a special programme of consultations with the authorities of the United States, Japan, the euro area, China and Saudi Arabia, which it is hoped will produce internationally concerted measures to reduce the disequilibria.

As to the governance of the IMF, there is a strongly perceived need to adapt voting and administrative powers to reflect the new economic position of the member countries – particularly the ones that have recorded the largest growth in the last decade – while preserving the "effective voice" of the poorest nations, especially those in sub-Saharan Africa. Reform will take place in two stages. In the first, which has already been completed, the quotas of the four most under-represented countries (China, Mexico, South Korea and Turkey) have been increased. In the second, to be completed by the end of 2008, the method of calculation of the quotas will be simplified to give more weight to GDP; the quotas of the under-represented countries will be increased a second time using the new criteria; and, finally, the IMF's Articles of Agreement will be amended to allow an

increase (at least double) in the “basic votes”, i.e. those that do not depend on quotas, in order to preserve the weight of the smallest countries.

As we speak, the World Bank too is initiating discussions regarding a programme of reforms that will give the poorest countries greater influence in decision making. Proposals on the table include an increase in “basic votes”, the appointment of more managers from the developing countries to senior administrative posts, changes to the method of appointing the President, and an increase in the number of representatives of African countries on the Executive Directors’ staff.

6. Conclusions

It is not easy to judge the governance of globalization, as this complex phenomenon affects the economic, social and political spheres in different ways and degrees from one country to another.

Economic and financial globalization is impossible to halt and difficult to govern, as was the first industrial revolution. Multilateral governance of a globalized economy, i.e. one in which goods and capital markets are highly integrated, must take account of the fact that the economic policies of the leading industrial and emerging countries are largely decided and enacted in a national context. Not enough attention is paid to the international repercussions that such policies have through the operation of global financial markets. This shortcoming was highlighted during the financial crises that overtook several leading economies

at the end of the 1990s. However, there is scope for public action at national as at international level to regulate, redistribute income, remedy “market failures”, and prevent and resolve financial crises.

National policies – monetary, fiscal, and structural – should aim to ensure domestic economic and financial stability. International cooperation must work to adapt the informal groups, such as the G7/G8 and the G20, and the multilateral institutions to the new situation. In the years following the crises of the 1990s major progress was made on the microeconomic front, to strengthen financial systems, establish internationally recognized standards in the banking, corporate, accountancy, and insurance sectors, and improve cooperation between the supervisory authorities of different countries.

Less progress has been made in the area of macroeconomic coordination owing to the reluctance of the leading countries in particular to put their domestic economic policy decisions second to the need for a less unbalanced world economic order and to the intrinsic difficulties of reforming the multilateral institutions. To give some examples, no solution has yet been agreed to the problem of effective multilateral surveillance procedures for the countries whose economic size gives them greater world influence; the division of tasks between the IMF and the World Bank is still unclear, particularly as regards their activity in poor countries; and, finally, attempts to reach agreement on the redistribution of voting powers in those organizations in favour of the emerging countries continue to flounder.

Leaving all this aside, there are two imperatives for the future. They concern the methods and the objectives of international cooperation. As to the methods, immediate action is needed to restore the role of multilateralism, not as a slogan but as a concrete principle informing the actions of the main actors on the international stage. In this context, Europe must play its part, pursuing common positions more vigorously and thereby exerting greater influence on the decisions of multilateral organizations. As to objectives and contents, there are now priorities that go beyond the normal sphere of economic and financial cooperation: alongside the reduction of poverty and inequality, increasingly important goals are combating diseases of epidemic proportions, protecting the environment, and controlling climate change.

TABLES AND FIGURES

Table 1

World GDP and trade (goods and services)

(average annual rates of change; flows at constant prices)

	GDP	Trade	Elasticity of trade [1]
1950-1959	4.6 [2]	5.8	1.25 [2]
1960-1969	5.0	8.5	1.68
1970-1979	4.4	6.6	1.48
1980-1989	3.3	4.4	1.30
1990-1999	3.2	6.4	2.01
2000-2006	4.3	6.8	1.58

Sources: IMF, *World Economic Outlook* and *International Financial Statistics* (various issues); A. Maddison, The World Economy: Historical Statistics, OECD, 2003.

(1) Ratio of the rate of change in trade to that in GDP.
(2) 1951-59.

Table 2

Industrial and emerging countries' shares of world exports of manufactures

(percentages; flows at current prices)

Exporters	1980	1985	1990	1995	2000	2005
Industrial countries	**81.2**	**80.3**	**82.4**	**77.9**	**73.2**	**68.3**
EU - 15 (1)	50.8	45.8	51.7	47.0	42.5	42.7
United States	13.1	12.8	12.5	12.7	14.5	10.6
Japan	11.3	14.5	11.8	11.9	10.1	7.9
Emerging countries	**18.8**	**19.7**	**17.6**	**22.1**	**26.8**	**31.7**
NIEs (2)	5.3	7.5	8.7	10.9	11.0	10.0
ASEAN 4 (3)	0.6	1.0	1.9	3.8	4.5	3.9
China	0.8	0.9	1.9	3.5	4.9	10.2
India	0.5	0.5	0.5	0.7	0.8	1.0
Other emerging countries	11.5	9.9	4.6	3.3	5.6	6.6
World	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Based on WTO data.

(1) Includes intra-European exports.
(2) Honk Kong, Singapore, South Korea and Taiwan.
(3) Indonesia, Malaysia, Philippines and Thailand.

Table 3

Composition of the emerging countries' exports of manufactures by sector (1)

(exports of the sector as a percentage of total exports of manufactures)

	1980	1990	2000	2003
Total manufactures	**100.0**	**100.0**	**100.0**	**100.0**
Labour and resource-intensive manufactures (2)	55.3	43.5	27.4	27.2
Low-skill and technology-intensive manufactures (3)	9.4	9.0	7.1	7.4
Medium-skill and technology-intensive manufactures (4)	5.9	13.1	19.0	20.5
High-skill and technology-intensive manufactures (5)	10.0	8.8	8.5	9.1
Electronic products, excluding parts and components (6)	8.2	13.6	15.1	17.0
Electrical and electronic products: parts and components	11.2	12.0	22.9	18.9

Source: Based on UNCTAD data, *Trade Development Report 2005* .

(1) Excludes exports of Central and Eastern European countries and the former USSR.

(2) Includes textiles and clothing, footwear and leather products, products of wood and non-metallic mineral products.

(3) Includes iron and steel and metal products and some branches of transport equipment, including ships.

(4) Includes rubber and plastic products, electrical and non-electrical machinery (excluding electronic products) and road motor vehicles.

(5) Includes chemicals and pharmaceuticals, aircraft and scientific instruments.

(6) Includes communications and household equipment, computers and office machines.

Table 4

Stocks and flows of immigrants in some OECD countries

(thousands of units)

		Stocks		Average annual flows	
		1995-99	2000-04	1995-99	2000-04
Austria (1)		684.52	739.92	65.80	87.88
	as a % of the population	8.59	9.15	0.81	1.08
Belgium		902.78	857.93	54.68	69.21
	as a % of the population	8.87	8.29	0.54	0.67
Denmark		245.14	265.92	23.94	21.54
	as a % of the population	4.66	4.94	0.45	0.40
Finland		79.14	101.74	20.11	10.21
	as a % of the population	1.52	1.92	0.39	0.20
France (2)		3,263.19	..	75.75	120.11
	as a % of the population	5.60	..	0.13	0.20
Germany		7,303.38	7,204.89	678.19	639.28
	as a % of the population	8.91	8.89	0.83	0.78
Ireland		111.42	182.84	20.54	33.32
	as a % of the population	3.03	4.65	0.56	0.85
Italy (1)		1,033.91	1,639.75	189.49	302.94
	as a % of the population	2.01	2.85	0.33	0.53
Luxembourg		148.18	170.74	10.12	11.13
	as a % of the population	34.80	38.10	2.39	2.50
Norway		164.02	197.18	22.94	27.73
	as a % of the population	3.68	4.23	0.52	0.61
Netherlands		679.46	691.94	76.19	82.24
	as a % of the population	4.33	4.28	0.49	0.51
Portugal		177.03	370.90	5.80	50.74
	as a % of the population	1.77	3.58	0.06	0.49
Spain (1)		633.91	1,390.62	78.16	448.68
	as a % of the population	1.61	3.32	0.20	1.08
Sweden		513.51	469.57	33.82	45.98
	as a % of the population	5.66	5.25	0.38	0.51
Switzerland		1,345.11	1,443.37	77.63	93.92
	as a % of the population	19.00	19.83	1.09	1.29
United Kingdom		2,072.60	2,622.40	262.82	414.34
	as a % of the population	3.58	4.50	0.45	0.70
Japan		1,465.27	1,841.09	251.48	357.34
	as a % of the population	1.16	1.43	0.20	0.28

Source: OECD.

(1) The average flows in the period 1995-99 refer to 1998-99.
(2) The average stocks in the period 1995-99 refer to 1999.

Table 5

Net flows of capital towards emerging countries (1)

(average annual flows; billions of dollars)

	1990-94	1995-99	2000-04	2005	2006
	Total Emerging Countries (2)				
Private capital	114.4	147.1	114.3	238.5	211.4
Direct investment	*45.8*	*139.6*	*166.9*	*255.9*	*263.3*
Official capital	16.6	12.7	-33.9	-151.8	-238.7
Reserves (3)	-50.1	-88.2	-266.2	-592.5	-666.3
	Africa				
Private capital	2.9	8.0	7.4	29.4	24.9
Direct investment	*1.7*	*5.5*	*15.2*	*28.6*	*27.6*
Official capital	2.4	-0.3	0.7	-14.4	-17.8
Reserves (3)	-1.2	-3.1	-14.5	-42.2	-62.0
	Central and Eastern Europe (4)				
Private capital	-0.5	29.1	45.3	113.5	88.8
Direct investment	*3.3*	*15.4*	*24.9*	*47.7*	*56.7*
Official capital	1.5	0.0	-2.4	-8.5	-3.2
Reserves (3)	-0.6	-13.7	-11.7	-46.3	-18.8
	Former URSS				
Private capital	-3.3	-5.2	4.1	37.6	18.8
Direct investment	*0.7*	*4.8*	*6.1*	*13.3*	*18.0*
Official capital	1.4	-0.7	-7.4	-22.5	-30.2
Reserves (3)	1.5	0.4	-27.6	-76.6	-115.0
	Asia (2)				
Private capital	38.5	44.0	48.8	64.0	97.9
Direct investment	*24.4*	*58.0*	*57.4*	*99.6*	*94.0*
Official capital	6.8	2.2	-10.7	-11.7	-8.4
Reserves (3)	-33.1	-52.6	-175.2	-286.6	-344.8
	Middle East				
Private capital	35.4	5.8	-10.8	-20.0	-31.8
Direct investment	*2.9*	*5.4*	*10.1*	*17.4*	*20.9*
Official capital	1.1	1.9	-20.9	-68.1	-172.2
Reserves (3)	-2.2	-3.8	-25.1	-106.1	-79.4
	Latin America				
Private capital	41.5	64.0	19.5	14.0	12.7
Direct investment	*12.8*	*50.0*	*53.1*	*49.2*	*46.1*
Official capital	2.3	6.5	6.4	-30.1	-12.6
Reserves (3)	-14.4	-12.1	-11.9	-32.8	-39.9

Source: IMF, *World Economic Outlook* (various issues).

(1) Balance of inflows and outflows to and from the area. Includes net direct investment, net portfolio investment and other short and long-term net investment flows, including official and private loans.
(2) Includes the NIEs (Hong Kong, Singapore, South Korea and Taiwan).
(3) A negative flow indicates an increase in the reserves.
(4) Includes Turkey.

Table 6

Foreign direct investment and worlwide activity of multinationals

(billions of dollars)

	1985	1990	1995	2000	2005
FDI inward stock	814	1,789	2,766	5,803	10,130
developed countries	592	1,419	2,067	3,976	7,117
developing countries	222	370	691	1,756	2,757
Sales of foreign affiliates	2,460	6,045	9,258	14,979	22,171
Gross product of foreign affiliates	664	1,481	2,067	3,152	4,517
Exports of foreign affiliates	700	1,366	2,045	2,585	4,214
Employment of foreign affiliates (thousands)	18,874	24,551	28,739	48,426	62,095
Memorandum items:					
FDI inward stock as a percentage of GDP					
World	*6.9*	*8.5*	*9.4*	*18.3*	*22.7*
developed countries	*6.4*	*8.2*	*8.9*	*16.2*	*21.4*
developing countries	*8.9*	*9.8*	*12.2*	*26.3*	*27.0*
Gross product of foreign affiliates as a percentage of world GDP	*5.1*	*6.8*	*7.1*	*10.1*	*10.1*
Exports of foreign affiliates as a percentage of world exports of goods and services	*5.4*	*6.2*	*7.0*	*8.3*	*9.4*

Source: UNCTAD, *World Investment Report* (various issues).

Table 7

Foreign direct investment inflows by country and region

(average annual flows as a percentage of the world total)

	1980-89	1990-94	1995-99	2000-04	2005	2006
Industrial countries	**73.9**	**68.1**	**66.2**	**68.8**	**59.2**	**65.1**
United States	34.6	18.1	22.0	16.0	10.9	14.4
Japan	0.4	0.8	0.5	1.0	0.3	-0.7
EU - 15	28.4	38.6	34.2	41.3	42.3	41.5
EU - 10 new member states	0.2	2.4	2.7	2.8	3.7	3.1
Emerging countries	**26.1**	**31.9**	**33.8**	**31.2**	**40.8**	**34.9**
Latin America	9.4	9.2	12.1	9.9	11.3	8.0
Argentina	0.7	1.6	1.7	0.4	0.5	0.3
Brazil	2.3	0.8	2.9	2.4	1.6	1.2
Mexico	3.0	2.6	2.1	2.5	2.0	1.3
Asia	13.8	19.2	18.3	16.0	20.7	17.3
China	1.7	7.3	8.2	7.0	7.9	5.7
Hong Kong	2.1	2.1	2.2	3.2	3.9	3.4
India	0.1	0.2	0.5	0.7	0.7	0.8
South Korea	0.3	0.4	0.6	0.7	0.8	0.0
Singapore	2.1	2.5	2.2	1.6	2.2	0.3
Central and Eastern Europe and former USSR (1)	0.2	1.1	1.7	3.1	5.4	6.4
World	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Memorandum item:						
World in billions of dollars	*94*	*201*	*607*	*826*	*916*	*1,230*

Source: UNCTAD, *World Investment Report* .

(1) Includes Turkey.

Table 8

Incidence of poverty (extreme indigence) in developing countries

	1981	1984	1987	1990	1993	1996	1999	2002(1)
	Persons who live with less than 1 dollar per day (in millions)							
East Asia and the Pacific	796	562	426	472	415	287	282	214
China	*634*	*425*	*308*	*375*	*334*	*212*	*223*	*180*
Europe and Central Asia	3	2	2	2	17	20	30	10
Latin America and the Caribbean	36	46	45	49	52	52	54	47
Middle East and North Africa	9	8	7	6	4	5	8	5
South Asia	475	460	473	462	476	461	429	437
Sub-Saharan Africa	164	198	219	227	242	271	294	303
Total	**1,482**	**1,277**	**1,171**	**1,218**	**1,208**	**1,097**	**1,096**	**1,015**
Total excluding China	*848*	*852*	*863*	*844*	*873*	*886*	*873*	*835*
	Persons who live with less than 1 dollar per day (% of the population)							
East Asia and the Pacific	57.7	38.9	28.0	29.6	24.9	16.6	15.7	11.6
China	*63.8*	*41.0*	*28.5*	*33.0*	*28.4*	*17.4*	*17.8*	*14.0*
Europe and Central Asia	0.7	0.5	0.4	0.5	3.7	4.3	6.3	2.1
Latin America and the Caribbean	9.7	11.8	10.9	11.3	11.3	10.7	10.5	8.9
Middle East and North Africa	5.1	3.8	3.2	2.3	1.6	2.0	2.6	1.6
South Asia	51.5	46.8	45.0	41.3	40.1	36.6	32.2	31.2
Sub-Saharan Africa	41.6	46.3	46.8	44.6	44.0	45.6	45.7	44.0
Total	**40.4**	**32.8**	**28.4**	**27.9**	**26.3**	**22.8**	**21.8**	**19.4**
Total excluding China	*31.7*	*29.8*	*28.4*	*26.1*	*25.6*	*24.6*	*23.1*	*21.1*

Source:World Bank, *World Development Indicators* , 2006.

(1) Preliminay estimates; not strictly comparable with the earlier figures.

Table 9

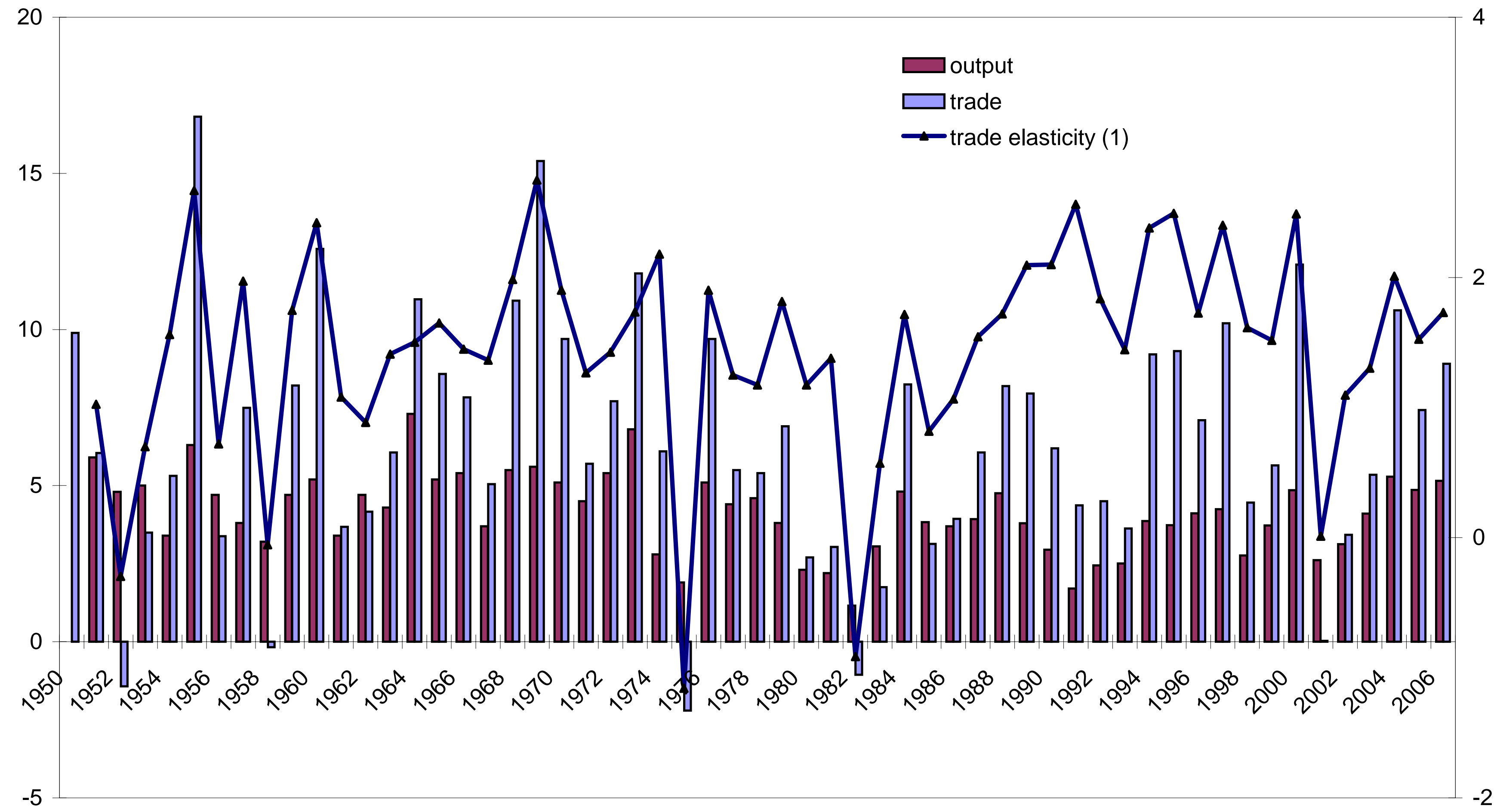
Indicators of human development

	Life expectancy at birth (years)						Adult literacy rates (percentage of persons aged at least 15)		Grosss enrollment ratio (%)						*Memorandum item: per capita GDP (constant 2000 international dollars) 2004*
									Primary school		Secondary school		Tertiary school		
	1960	1970	1980	1990	2000	2004	1990	2004	1991	2003 (1)	1991	2003 (2)	1991	2003 (3)	*2004*
High-income countries	68.8	70.8	73.6	75.9	78.0	78.7	..	..	102.3	99.9	92.2	105.0	46.3	66.6	*28,482*
OECD countries	69.0	71.0	73.8	76.1	78.2	79.0	..	..	103.6	101.5	94.1	107.2	47.4	68.7	*29,413*
Middle and low-income countries	44.8	56.0	60.1	63.0	64.5	65.2	68.9	80.1	101.1	104.9	46.4	61.0	9.0	17.0	*4,417*
Middle-income countries	45.8	60.9	64.9	67.7	69.2	70.2	80.8	90.5	111.8	110.6	54.3	74.9	11.0	24.3	*6,210*
upper middle income	..	64.8	66.5	69.1	68.7	69.1	91.2	94.8	105.0	106.0	67.7	87.1	25.7	40.0	*9,614*
lower middle income	43.4	59.9	64.5	67.4	69.4	70.5	78.4	89.6	113.4	111.6	51.1	72.1	8.0	20.1	*5,422*
Low-income countries	43.1	47.8	52.5	56.1	58.1	58.7	48.6	61.7	86.8	99.8	35.0	45.6	5.2	8.7	*2,111*
World	50.4	59.1	62.6	65.2	66.6	67.3	..	..	101.2	104.3	52.2	66.0	14.5	23.5	*8,187*
Poor countries (LDCs - UN classification)	39.5	43.5	47.2	49.8	51.1	52.1	44.4	..	63.4	90.6	14.8	35.0	..	3.3	*1,242*
Heavily indebted poor countries (HIPCs)	40.3	44.4	48.0	49.2	48.7	49.3	50.2	62.2	65.8	90.2	16.2	24.9	2.5	3.2	*1,180*
Sub-Saharan Africa	40.6	44.6	48.1	49.2	46.1	46.2	50.6	..	71.5	92.5	22.5	29.6	..	5.1	*1,781*
Latin America	56.3	60.4	64.6	68.1	71.2	72.2	84.9	90.2	103.8	121.3	48.9	87.1	17.1	25.9	*7,314*
South Asia	43.9	48.9	53.7	58.7	62.6	63.4	47.1	59.5	96.9	102.9	41.7	49.0	5.7	9.8	*2,635*
East Asia	38.9	59.1	64.4	67.2	69.1	70.3	78.8	90.7	119.0	112.9	46.9	68.8	4.6	16.8	*4,920*
Europe and Central Asia	..	67.4	67.5	69.1	68.3	68.8	96.0	98.9	98.0	102.1	83.0	92.1	33.1	47.1	*7,890*
Middle East and North Africa	47.2	52.6	58.3	64.3	68.1	69.4	51.8	..	95.4	103.5	56.6	67.2	12.6	23.3	*5,346*

Source: World Bank, *World Development Indicators* , 2006.

Figure 1 World output, trade and trade elasticity

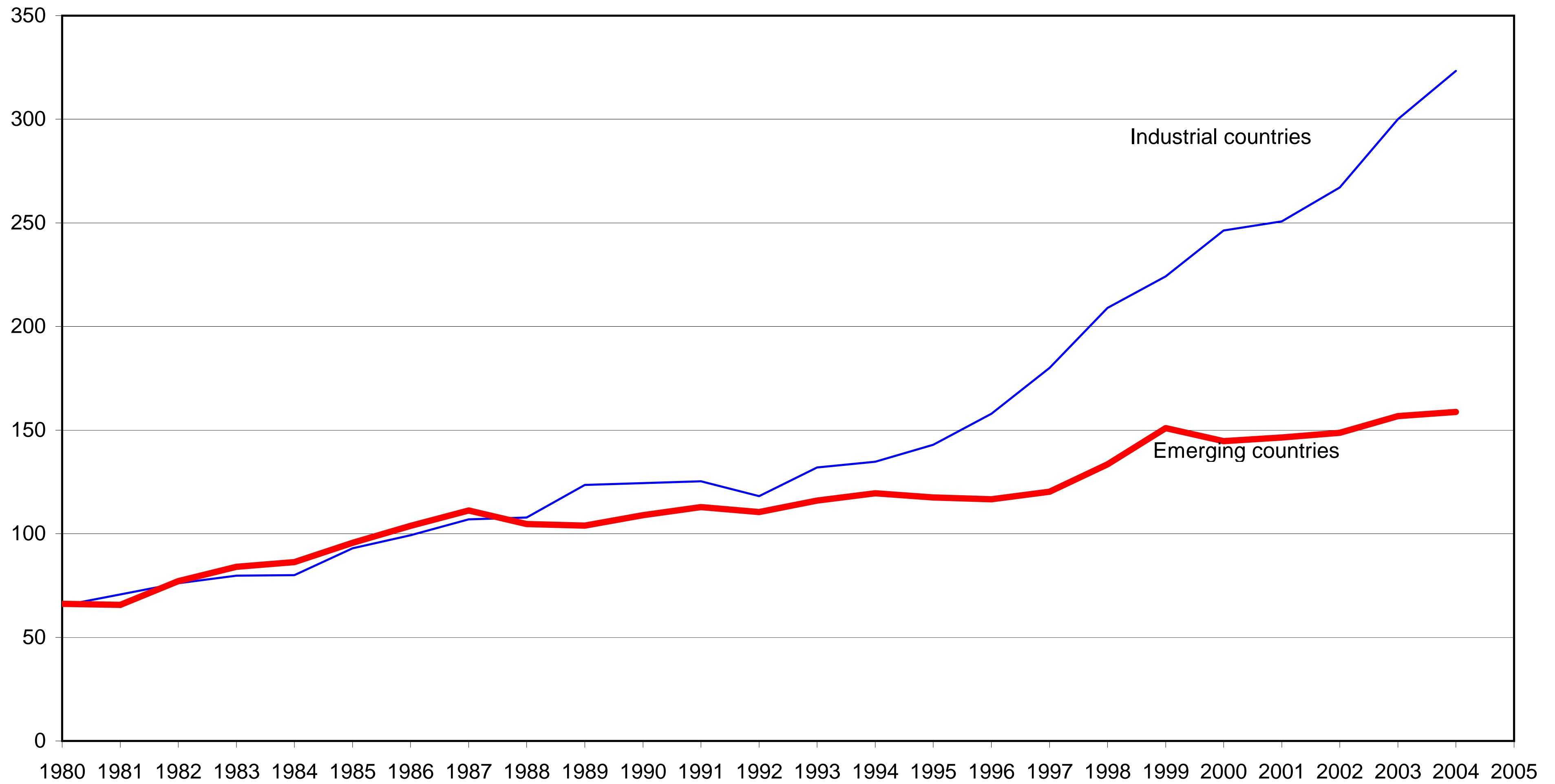
(percentage changes on previous year; flows at constant prices)



Source: IMF.

(1) Ratio of the change in trade to the change in output. Right-hand scale.

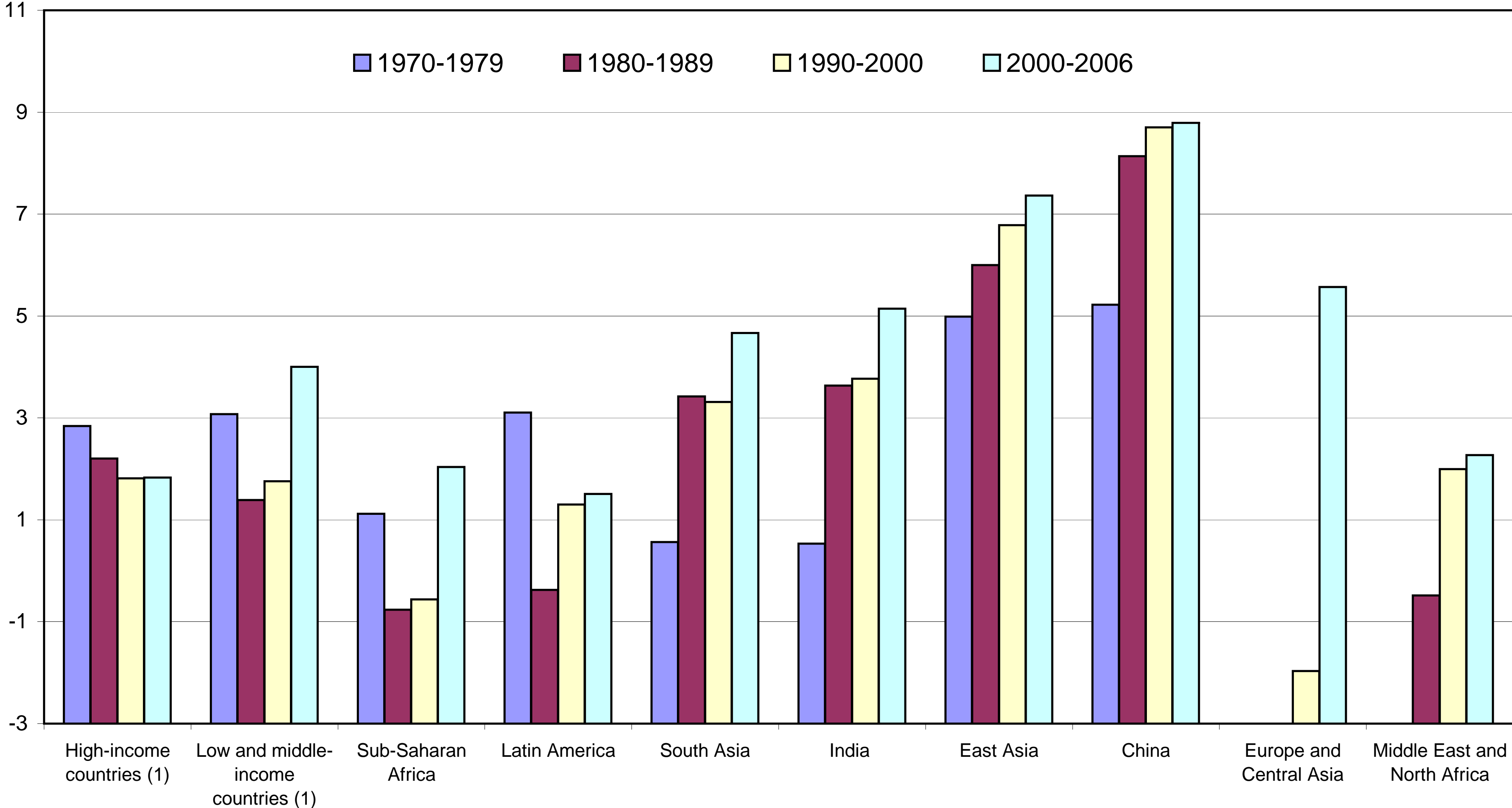
Figure 2 Gross stocks of foreign financial assets and liabilities as a ratio to GDP (1)
(sum of financial assets and liabilities; percentages)



Source: Based on Lane Milesi-Ferretti data bank.
(1) For each group, weighted average to the countries' GDP.

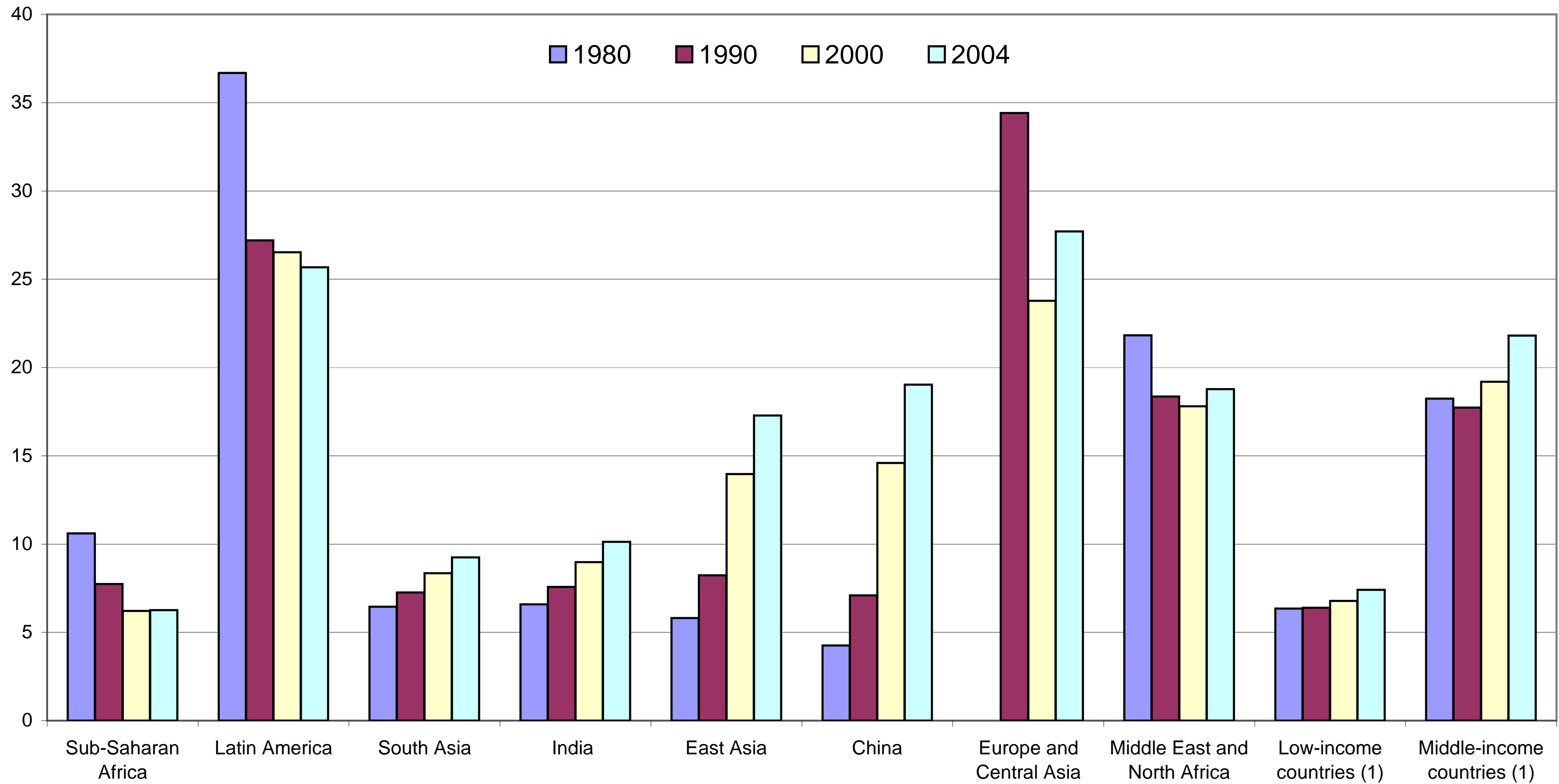
Figure 3 Growth of per capita GDP

(percentage changes; annual averages in the period indicated)



Source: World Bank.
(1) World Bank classification.

Figure 4 Per capita GDP valued at purchasing power parity
(as a percentage of the level in the high-income countries)



Source: World Bank.
(1) World Bank classification.

Figure 5 IMF loans

(stocks in billions of SDRs)

Total — Industrial Countries

90 80 70 60 50 40 30 20 14 10 0

1970 1980 1990 2000 2007

Year

Main debtors

(millions of SDRs; December 2006)