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The Globalisation and its Implications for the Economic Development of Latin America *)

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Abstract

The process of globalisation has in several ways an impact on the Latin American Economies. The recent developments give a carefully optimistic view on the economic consequences for these countries. While all of the Latin American nations still lag behind the industrialised countries with respect to their integration into global information networks, the digital divide seems to be narrowing in the near future. Concerning the trade and production structure most countries of the region are moving towards a higher degree of diversity while industrialisation and modernisation are progressing. While capital inflows into the region have spurred growth, the experience of the financial crisis in the emerging markets during the second half of the 90s showed the necessity of creating sound financial institutions. In addition other institutions e.g. in the field of education, administration and jurisdiction have to be built up for ensuring the possible benefits of a globalised world.

JEL: F0, O1

Keywords:
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1. Introduction

At the beginning of the 21st century the world is oftenly perceived as becoming increasingly "globalised", in which the actors develop global strategies and act globally, resulting in global transactions shaped by global institutions. The term "globalisation" is not exactly defined, but encompasses many dimensions: economic as well as political, social or cultural.

Perceived as a complex phenomenon, the impacts and consequences of the "globalisation" are frequently discussed and analysed on specific subsystems of society. One dominant object of research are the implications of globalisation on the economy. Starting from that type of research, this paper is concerned with the effects of globalisation on the perspectives for Latin America's economic development. The most important challenges for the region will be identified and some possible reactions analysed, in order to enhance a successful participation of the Latin American countries in the process of globalisation.

In this paper the term "globalisation" will be defined pragmatically as a process of increasing internationalisation of economic relationships. This process will be split up in several elementary, interdependent sub-processes. The first section of the second chapter (2.1) is concerned with the global integration of telecommunication networks and it's implications for Latin America as one fundamental sub-process. Section 2.2 discusses Latin America's increasing participation in the global division of labour and global trade flows. The intensification of international capital movements is examined in section 2.3. Finally, building on the results of the previous sections, we look at possible options of national economic policies for reacting on the new developments.

Another important feature, the globalisation of labour markets and the problems of international migration, will not be discussed due to its important non-economic determinants.

The consequences of the above mentioned sub-processes of globalisation for economic growth prospects are the main concern of the study. In addition, possible effects on employment and income distribution are considered. In the end, an agenda for economic policy is derived that is supposed to facilitate Latin America's successful participation in the global economy and smoothen possible conflicts between growth prospects and distributional concerns.

2. Patterns and consequences of sub-processes of globalisation

2.1 Latin Americas participation in global information networks

A globalised world is a world with intensified international transactions of all kinds. These transactions are facilitated by transportation and telecommunication infrastructure; therefore a country's successful participation in the process of globalisation is based on its integration in the global telecommunication networks. The following section gives an overview of the actual situation on the standard of IT-infrastructure in Latin America. The region's potential for participation in the global economy shall be derived from the data. Possible implications of the evolving "information society" for the Latin America's economic development as well as priorities for economic policy will be discussed thereafter.

Compared with the economies of North America, Europe or East Asia, the Latin American countries are poorly endowed with IT-equipment, represented e.g. by telephone lines, cellular phones, internet usage or PCs. Measured by the Information Society Index (ISI), Latin America is ranked in the middle of the global distribution, below the world-wide average.[1] In 1999 the number of telephone lines per 100 inhabitants was 14.39 in South America compared with 66.1 in the US. (ITU (2000), p.87). The picture for cellular phones looks a bit more friendly: 8.12 users per 100 inhabitants in South America face 30.78 users per 100 inhabitants in the US. (ITU (2000), p.94)

The figures for Central America are even below those for South America. Consequently, only relatively few Latin Americans have access to the information, the supply and the demand that are increasingly offered and traded by the internet.

The regional differences in the IT-infrastructure in Latin America are immense, too. While Argentina and Uruguay have established 20.11 and 27.07 telephone lines per 100 inhabitants, Peru or Honduras are found on the lower end of the ranking with figures of 6.69 and 4.42 respectively. (ITU (2000), p.87)

Inside each country the figures on IT-infrastructure differ significantly between urban and rural areas.

[1] For an international comparison see UNESCO (2000), p.167f. and p.242.

But the dynamic development of the region gives way to some optimism about its future. The growth rates of the IT-, and especially the internet-industry are high and lie above the international average. And while the predictions for the near future differ widely, all expect continuing very high growth rates of the sector. (Latin American Newsletters (2000), p.2ff. and UNESCO (2000), p.244f.)

The privatisation of the former public telecommunications companies in many countries have set free dynamic forces in the rapidly changing and growing industry. The participation of foreign investors resulted in an inflow of capital and in the access to state-of-the-art know how and technologies. But also the still state-owned companies of Uruguay and Costa Rica successfully modernised their telecommunication networks.[2] Finally, in the second half of the nineties new firms appeared on the scene – mainly internet services – whose success can stimulate a new generation of entrepreneurs in Latin America.[3]

The global change towards an information society opens a window of opportunity for Latin America. In the new economy, change is rapid, new actors emerge and can succeed in challenging incumbents.[4] In theory, this road is open to Latin American entrepreneurs as well. The markets in Latin America have been liberalised, making access for new suppliers possible. Foreign capital can flow freely into the countries to finance promising ideas and ventures. But these activities of young entrepreneurs hinge on new forms of finance and consulting. And with respect to stimulate start-ups, supply of venture capital or well-functioning stock markets, Latin America still has a long way to go.

A quick adaptation of the new technologies under effective institutions could make a leap-frogging of old technologies possible.[5] New technologies as e.g. mobile communication open up opportunities for rural areas, too. Education and skills gain importance for the competitive advantage of a region. The dominance of romanic languages in Latin America supports the intraregional standardisation of the new technologies and the development of continent-wide markets, making possible the realisation of economies of scale. And the increasing number of interpersonal relations between Latin America and the centres of IT-development in the US, resulting from migration, may result in knowledge flows back to Latin America.

Today, the new information- and telecommunication-technologies have reached a level of maturity that leads to high productivity growth in the developed world, predominantly the

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[2] Uruguay and Costa Rica have the telephone network with the highest density in South and Central America respectively.

[3] Prominent examples are the internet-service provider *Starmedia* or *patagon.com*. A good overview on the *new economy* in Latin America offers Latin American Newsletter (2000).

[4] New companies as *aol*, *amazon* or *Dell Computer* quickly became market leaders by introducing new technologies first.

[5] Part of these essential institutions are an effective regulation of the telecommunications industry and the e-commerce.

US.[6] Looking from a supply-side perspective, increasing experience with IT will raise labour and total factor productivity and with the appearance of new technologies, the structure of capital goods and services is becoming increasingly differentiated. In addition, information technology as general purpose technology has positive effects on the demand for capital goods of all industries. Also in Latin America, the IT-related industries create new types of jobs and employment opportunities. Up to now, this holds true mainly for the IT-services sector.[7] Only few successful examples of a local hardware production can be found, most prominent Intel's investment in a chip plant in Costa Rica.

The beginning of the information economy in Latin America is accompanied by a necessity to invest heavily in hardware, software and services, a demand that appears in addition to the traditional investment needs due to industrialisation. Since up to now Latin America produces IT-products and –services only to a small extent, it is heavily dependent on imports, and the traditionally weak balance of payments are set under additional pressure. This problem is eased by the participation of foreign firms in the regional market, making the financing of IT-investments at lower capital costs possible.

Besides the investment in physical infrastructure, the information society depends on an additional effort on investment in human capital. A shift in the focus of education will become necessary. But the endowment of schools with IT-equipment and skilled teachers is only at the beginning of its development. Again, Costa Rica can serve as a good example for the other countries of the region. (UNCTAD (1999), p.184ff.)

Latin America is a continent with a very high degree of inequality in the distribution of income and very unequal access to resources as land, capital or high-quality education. This tendency may not be repeated on the continent's way into the information society if a digital divide inside the continent shall be avoided. A participatory process of globalisation means access of all groups in the society to information technologies. This is not only the pre-condition for common access to globally available information, but in addition allows the development of entrepreneurial activities for everybody who is willing to do so.

It is straightforward to assume that the endowment of the urban upper and middle classes with IT will quickly converge to the level of the industrialised countries by private initiative. But the construction of an exhaustive infrastructure implies high additional investments, and the high rate of technological change in IT will keep the investment needs high for a long time. This raises problems for economic policy makers. Which role has the state to play in the provision of infrastructure in those regions that are not well-served by the private sector? To what degree can the poorer Latin American countries finance these investments on their own? The state should – in co-operation with foreign partners – support the access of the

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6 On the hypothesis that technological revolutions first slow down and then, with a time lag, raise economic growth, see David (1991).

7 For a more detailed survey on the developments of demand and production in the IT-sector see bfai (2000).

marginalised groups and improve the infrastructure in rural areas, e.g. by establishing public internet stations. In addition, the development and distribution of information which is especially valuable for the poor should be promoted.[8]

Further areas for public activity exist. The educational policy has to lay the intellectual foundation for the participation in the information society. And the framework for start ups has to be improved or even built up.

Finally, the question arises whether programs should be implemented that aim at the development of an own know how in IT-industries. Negative examples – e.g. the failure of Brazil‘s microelectronic program – indicate that this aim will not be reached by the protection of the infant IT-industries. Instead, incentives have to be set for the establishment of foreign firms and the careful promotion of local centres of competence in R&D has to be designed. This may not lead to redundancy by parallel research to the developed countries. International co-operation with research centres of the developed world has to be established, own initiatives should be complementary to theirs.

For limitations of space we cannot discuss these problems in more detail. But if the consequences of the global information society for all Latin Americans shall be positive, politicians have to find solutions to these topics.

2.2 The development of Latin American trade flows

The increasing global information flows accompany and facilitate the international trade in goods and services. And a paradigmatic shift in trade policy is a second source of integration of global markets. In Latin America, especially the last two decades have shown drastic progress in the opening up of the economics on a multilateral (e.g. an increasing membership of Latin American countries in the GATT/WTO) and regional (Mercosur, NAFTA, Andean Common Market) basis.[9]

As a consequence of reduced transaction costs and trade liberalisation, three main long-term tendencies in the development of world trade can be identified: Since World War II, the growth rate of world trade has on average been much higher than that of world production. The share of intra-industry trade has been increasing, the share of inter-industry trade has declined. In this process, the value chain of one final product is getting more and more internationalised. The following section gives an overview to which degree Latin America could participate in these processes. Furthermore, we will discuss possible consequences of the continent’s integration into the world-wide division of labor.

As in other regions of the world, the volume of foreign trade of the Latin American economies increased manifold since the 1950s. But in the same period of time, their share in

8 For opportunities of poor-centred services see World Bank (1999), chapter 8.

9 For a more encompassing discussion of the general trends of global integration see Frankel (2000).

total world trade has been shrinking.[10] They could or rather – under the paradigm of import-substituting industrialisation – did not want to keep pace with the increasing speed of globalisation.

But in the recent past, this trend has reversed. During the last two decades, the importance of foreign trade increased significantly. The ratio of the sum of exports and imports to GDP increased from 21.8% in 1980 to 32.0% in 1998.

Which trade relations have intensified the most? Is the recent rise of Latin American trade a consequence of intensifying globalisation or rather the result of a tendency towards regionalisation of the continent, made visible by the establishment of free trade areas and trade unions, e.g. NAFTA or Mercosur. A huge share of the increase in foreign trade stems indeed from intraregional transactions and especially from trade flows inside regional trade agreements. For example, Mexico could expand its trade with the US and Canada, its NAFTA-partners.[11] And in the *Cono Sur*, between 1990 and 1998 the volume of intraregional trade between Argentina and Brazil rose from 2.07 to 14.41 billion US-$.[12] Therefore, an increasing division of labour between Latin America countries can be observed.

Parallel to the process of deepening regional integration, the tendency of a slowly increasing participation of Latin America in the global economy can be made visible if one looks at the foreign trade with non-American countries. During this process, and thanks to the rise of the East Asian economies, the pattern of Latin America’s trade partners has become more diversified. In 1997, Peru delivered with 23.1% nearly a quarter of its total exports to Asia, Chile with 35.4% even more than a third.[13]

Traditionally, Latin America has been an exporter of raw materials and an importer of industrial products. This pattern of trade has changed only slowly, but it has changed significantly. Raw materials and natural resource based industrial products still contribute the major share to several countries’ export earnings. Venezuela’s export is still dominated by crude oil, while Chile’s export growth rests mainly on mining, forestry and fishery products.

But progress in the competitiveness and therefore export performance of industrial products can be observed. The two dominant economies of the region, Mexico and Brazil, could establish themselves on world markets as exporters of manufactured goods.[14] And even in the

[10] Between 1963 and 1975 and between 1980 and 1990, the average growth rates of the Latin American countries‘ foreign trade had been below the world average. The share of Latin America in world exports declined from 8% to below 4% between 1963 and 1990. See Gutierrez de Pineres; Ferrantino (2000), p.3 and p.6.

[11] While Mexico‘s total exports quadrupled between 1990 and 1997, the share of the US in total exports even increased faster from 70.2% to 84.5%. See UN (1993), p.606 and UN (1998) p.627.

[12] This increase reflects a growth of the share of bilateral exports in total exports of both countries from 4.7% to 18.9%. See CEPAL (2000), p.568ff. and p.600ff.

[13] See UN (1998), p.178 and 754.

[14] Between 1980 and 1998, in Brazil, the share of manufactured goods in total exports rose from 37.1% to 54.2%, while in the same period in Mexico even more pronounced from 12.1% to 85.1%. See CEPAL (2000), p.99.

less industrialised countries, the degree of export diversification has risen, reducing those countries' dependency on one or some volatile markets for raw materials (Gutierrez de Pineres; Ferrantino 2000).

A Latin American speciality of the last decades is the increasing importance of *maquiladora*-exports[15], mainly from Mexico and the Central American and Caribbean states to the USA. Although their contribution to long-run development is, as in the case of raw material exports, heavily discussed due to their low linkages to other sectors of the economy, their positive effects on employment and foreign exchange earnings should not be underestimated. In addition to exports of goods, many Central American countries could expand their services exports by building up a successful tourism industry.

Its increasing integration into the global economy opens up an immense growth potential for Latin America, paralleled by short-term adjustment costs and some long-run risks. In the new trade and growth theory, the openness of an economy sets off positive long-run growth effects. Only the interaction with foreign partners opens up the opportunity to install foreign technology, to learn its use and to adapt it and to develop it further, thereby raising local productivity (Grossman; Helpman 1991). Taking into account the low level of domestic research efforts and experience in Latin America, these learning processes are of key importance.[16] In addition, the restrictions of a low level of domestic demand can be offset, only the world market permits the exploitation of economies of scale of present production technologies in many industries. And the high intensity of competition by the entry of foreign suppliers raises the pressure to produce with more effort and more flexibility.[17]

The evidence of empirical investigations weakly confirms the positive relationship between openness and growth of an economy.[18] And especially the negative experiences of the Latin American countries during the period of import-substitution makes clear that an autocentric development excluding actors from the world markets will rarely prove to be successful.

The expected positive growth effects of foreign trade are often questioned by the theoretical argument that the relative affluence of Latin America in natural resources and its relative scarcity of human capital will result in a trade-induced pattern of specialisation in industries with few learning and growth effects and with few possibilities to develop own research experience. To counter this trade-imminent tendency, the Latin American governments should not react with a new policy of protectionism but with higher investment in education and the careful development of research competence in industries linked to the natural resource endowments. Further, the entry of new products into foreign export markets has to be

[15] Maquila are assembling industries using the relatively cheap unskilled labour in Mexico and Central America.

[16] For further information on R&D effort in Latin America see RICYT (1998).

[17] An encompassing discussion of the allocation- and growth-enhancing effects of foreign trade see Pols (1999).

[18] For two articles representing the huge empirical literature on the growth effects of foreign trade, see Harrison (1996) and Edwards (1998).

facilitated with export promotion programs.[19] These globalisation-induced new requirements for economic policy are one of its most important positive effects for development.

Which parts of the population will benefit from an export-oriented development? The lowered barriers protecting the domestic economies will result in the increasing presence of new competitors and consequently to a reduction of inflationary pressures, while new export opportunities will arise for local producers. Every consumer will benefit from the "imported" price stability. But the permanent adjustment dynamics resulting from the factual or potential competition of foreign producers in the open economy raises the pressure on the local producers and employees.[20] The only options to react to this pressure are productivity-increasing measures, reductions in the real wage or job cuts and unemployment.

According to the traditional trade theory, with sufficiently flexible labour markets, new jobs should rapidly evolve in the industries with comparative advantage or in the non-tradables, e.g. services sector. To keep the inevitable adjustment costs of the structural change relatively low, the labour market institutions shall be designed in a way not to impede labour mobility. Highly skilled workers have the best precondition to react flexibly and to benefit from the new employment opportunities in an open economy and to use their abilities globally, while less skilled workers will be confronted with the increased competition from abroad. As a result, those will suffer most from the adjustment pressure that can be found at the lower end of the income distribution. Therefore, the divide between the rich and the poor will be widened by the intensified competition. Resistance towards globalisation can be avoided and acceptance raised only, if the winners of the globalisation process are willing to accept a certain compensation of the losers by social programs and an improvement of their opportunities to participate in the globalisation process, e.g. by small credit and educational programs. But the populists' call for new protection shall be left unheard, and the open trade policy maintained and supported by the necessary measures in the fields of educational, labour market and export promotion policies, if the opportunities of the globalisations shall be gripped.

2.3 The Role of International Capital Flows

One key element of economic globalisation is the emergence of worldwide markets for goods and services as well as for capital. The increasing mobility of the factors of production is best illustrated by the case of international capital flows. Policies of liberalisation and the revolution in communication technology are responsible for an enormous decrease in transaction costs intensifying the international capital flows in the last decade. Latin American private net inflows of capital increased from 15 billion US$ as average for the

[19] These policies should be paralleled by a stability-oriented macroeconomic policy and the setting of a institutional order to reduce further growth impediments (see section 2.4).

[20] A distinction has to be made between the one-time adjustment effect of a liberalisation and the permanent effect of the greater innovation dynamics of a global economy.

period 1986-1990 of to an average value of 40 billion US$ for the period 1991-1995. (Mewes (2000).) A better access to international capital markets is advantageous for developing countries as poor countries can realise higher levels of investment when the restriction of domestic saving is alleviated. (Felderer; Homburg (1994).) Nevertheless it is often argued that a greater openness for international capital results in a higher feasibility of financial crises. (Kaminsky; Reinhart (1999).) The recent examples of Mexico, Asia and Russia provide an example of how a financial crisis can affect investment and production in the real sector and finally lead to recession. (World Bank (2000).) Therefore we have to answer the question of how a country could realise the gains of open capital markets while avoiding the threats of increased volatility. For the Latin American countries this problem is even more severe as the volatility of capital flows was significantly higher compared to more developed regions. Whereas during the period from 1983 –1990 Latin America witnessed strong net outflows of capital, the following years until 1993 showed fast growing inflows which were again falling sharply in 1994 and 1995. An extrapolation of this trend points to a further growing volatility in the future. (Griffith-Jones (2000) p.11 f.) For the following considerations it is useful to distinguish between Foreign Direct Investment (FDI) and Portfolioinvestment (PI). PI is either investment in bonds or equity whereas FDI generally implies the investors' interest to exert a long term influence on the management of the acquired unit in the host country. (Lipsey (1999) p. 5.)

As PI often reflect a short term interest of the investors they imply a potential danger for the host countries as a sudden withdrawal of large amounts could enhance a financial crisis and finally lead to a recession. This potential threat is most important for the emerging economies as their institutional framework in the financial sector is weak compared to that in more developed countries. In addition to the long term process of financial sector reform there are two measures suitable for reducing the short term risk of contagion.[21] First the introduction of controls of short term flows would reduce volatility and therefore lessen the feasibility of a crisis. An example for likewise preventive measures is the introduction of unremunerated reserve requirements introduced by the Chilean government. (Gregorio et al. (2000) and Laban; Larraín (1994).) A second remedy would be to provide better access to international liquidity for developing countries in order to reduce the effects of a beginning crisis. A detailed evaluation of these instruments is not possible in the context of this article.[22] We will just point to the fact that their introduction creates costs and may negatively affect the allocative efficiency of financial markets.

The theoretical effects of FDI are ambiguous. In the economic literature one can find several works claiming negative effects of FDI for the economic development of the host country. One of the main reasons for this result is the non-competitive structure of markets in the host

[21] About the institutional reform of the financial sector see World Bank (1998) S.41f.

[22] For an evaluation see Weltbank (2000) S. 97f.

countries allowing the international companies to extract monopoly rents. Furthermore international enterprises will strengthen their market power by forcing their local competitors to exit the market. (See Moran (1998.) Nevertheless there are also theoretical and empirical contributions assuring the positive impact of FDI on economic development. Following this approach FDI does not only result in growth of capital formation but will also mean an import of technological knowledge and management skills. (See Liebig (1998) S.19f.) The diffusion of these growing skills and spillover-effects allow an upward shift of the national transformation curve. (See Borenszstein et al. (1995).) However, the Brazilian example shows that the acquisition of local producers by international companies resulted in a concentration of their R&D-activities in the home country limiting the above stated effects. (See UNCTAD (1999).) On the other hand international companies usually offer training on the job enhancing human capital formation and stimulating growth. (Moran (1998).)[23] Summarising the necessary conditions for a positive impact on growth of FDI we first of all find a competitive market structure and the existence of linkages between the sector of investment and the host economy stimulating demand for intermediates and capital goods. Moreover the augmenting productivity of forwardly linked sectors and a transfer of technology and knowledge will further foster economic growth. Considering the empirical and theoretical evidence it is most likely that open countries with a high attractiveness for FDI will perform better than those avoiding an integration in the world economy. (World Bank (2000), Nunnenkamp (2000) or Oman (1999).) The significantly lower volatility makes FDI more suitable for sustainable growth than PI as a high share of FDI reduces the feasibility of financial crisis.[24]

World-wide FDI for the annual average of 1991 – 1996 reached a volume of 245 billion US$ augmenting to 400 billions in 1997. (see Cepal (1998).) During the first half of the 90s the countries of East Asia were the top recipients of FDI among the emerging markets. After the financial crisis in Asia in 1997 the Latin American countries have regained this position. (see World Bank (2000).) Although one should keep in mind that a large share of the FDI inflows to the region can be explained by the massive privatisation of formerly state-owned assets. Graph 1 in Appendix shows the development of FDI for important countries of the region.

The inflow of FDI is considerably high in the big Latin American countries. But that is not to say that only the big countries gain from the intensification of international investment in the region. By dividing FDI by Gross Domestic Capital Formation as we have done in Graph 2 this perception will change as smaller countries show a high percentage of foreign investment. In this sense FDI can help the smaller countries avoiding the investment restriction imposed on them by lacking domestic savings and profit from the globalisation process through higher investment.

[23] Especially the endogenous growth theoy highlights the role of Human capital formation for growth, see Lucas (1988).

[24] For example during the Mexican crisis we only noticed minor outflows of FDI. (Graham, Wada(2000).)

As shown above the higher mobility of international capital means a great opportunity for the Latin American countries to further enhance their economic development. But at the same time the feasibility of financial crisis will increase making it necessary to rather attract long term flows or at least reducing the possible negative effects of short term flows. Hence, the Latin American countries should adopt a policy aiming on the one hand at attracting FDI and on the other hand at controlling the possible destabilising impacts of speculative flows. Their policy should be directed to macroeconomic stability and a high institutional quality in the financial sector. If the Latin American countries can successfully face these problems they will be able to realise huge gains from the globalisation of financial markets without having to fear short term instability.

2.4 The Loss of National Sovereignty

Critics of the globalisation often stress the fact that this development implies the loss of a sovereign economic policy in the participating countries. International investors and organisations limit the countries domestic policy options. According to this view competition for international investment and the nations´ struggle for competitiveness lead to a constant decrease of environmental and social standards. Some contributions state that this situation is comparable to a prisoners dilemma where the rational action of individuals aimed at fostering international investment leads to a non-efficient collective situation. (Vanberg (2000).) To tackle this problem several authors suggest the introduction of international rules assuring minimum standards in social- and environmental policy.[25] Looking closer at this argument we doubt that globalisation is the one and only cause for the observable changes in economy and society in recent years. First of all it is important to understand that domestic policy has always been subject to the intervention of interest groups and hence was not autonomous before the phenomenon of globalisation became important. (Pritzl (1997).)

Furthermore the emergence of the Washington Consensus as the central paradigm of development policy in the 90s changed the former views radically. It proposed a policy aiming at reducing the state influence on the economy, keeping the markets open and ensuring macroeconomic stability. (Williamson (1990).) Hence it is not only the emergence of globalisation which brought about the observed policy changes but as well the mentioned paradigm shift towards a more liberal doctrine. To put it another way: one can say that deregulation, privatisation and the reform of macroeconomic policy cannot only be explained by globalisation but also by a change of thinking concerning the theory of development policy. (Rosenthal (1997).) Nevertheless a higher degree of openness will enforce competition between national policies shaping the competitiveness of the immobile factors of production in an economy. Considering the example of tax competition between nations the phenomenon of social dumping will not result. Instead, we will experience an efficient ratio of tax rates and

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[25] For a discussion of international standards see Sautter (1995) S.193 f.

the provision of public goods by the governments. Consequently a national policy denying the necessity of efficiency in the public sector could endanger the possible gains of globalisation. In Latin America the experience with the lost decade of the 80s prepared the ground for a policy of reform undertaken during the 90s according to the propositions of the Washington Consensus. (Corbo (2000; Sautter; Schinke (1996).) Hence one could argue that globalisation restricts the choices of domestic policy. But certainly this restriction avoids national policies that are contradictory to the goals of economic growth and successful development as we have experienced in Latin America during the 70s. Furthermore the international restriction limits the influence of interest groups which was already mentioned above. Therefore the further growing international restriction of sovereignty seems to be rather a positive than a negative phenomenon as it helps to establish a framework for national policy options according to the goals of fostering sustainable economic growth and avoiding inefficient but popular policies. Nevertheless the experiences with a policy following the Washington Consensus are ambiguous showing the importance of a suitable institutional setting for a successful economic development. (World Bank (1998).) Therefore, the big challenge for national economic policy is the creation of a suitable framework for growth and development. (Rodrik (2000).) Thus the question to be answered by the Latin American countries is not if institutions matter but what types of institutions are crucial for the process of economic development and how they can be acquired at low cost. Considering the current situation the main focus of governmental action should be concentrated on the sectors discussed in the following paragraphs. (World Bank (1998).)

The importance of a stable financial system reducing the feasibility of crisis was already mentioned in section 2.3. A direct challenge for shaping the institutional setting of Latin American countries is the ubiquitous question of social security as the region is characterised by an unequal distribution as well as by severe poverty. (Inter-American Development Bank (1998) and Sautter; Schinke (1996).) A globalised, market based economy induces positive effects on welfare but simultaneously raises the risk of loosing the capability to generate a sufficient income because of illness or unemployment. As distributive justice and the possibility to lead a life in dignity are claims that cannot be fulfilled by the market mechanism it is necessary to create suitable institutions for this purpose. The justification of an efficient social system is given on the one hand by ethical considerations but on the other hand by the conservation of a social and political consensus enhancing the institutional stability of a market economy. (Rodrik (2000).) Looking at the current situation in Latin American countries and especially the provision of social security to the poor urgent measures have to be taken to reduce poverty and help conserving this consensus. (Sautter; Schinke (1996).) In this respect the reform of the educational system is crucial as the current distributional situation is reflected in the individual access to education. Giving the poor the possibility to receive higher education could break the vicious circle of distributional inequality and low levels of education. (Inter-American Development Bank (1998).) The conviction that better education of the population is a necessary condition of a successful participation in globalisation has lead to many reforms in the Latin American countries. (World Bank (1998).) A good example for the various efforts in this context is the Brazilian initiative to improve the educational quality of the school system. (UNESCO (1998).) In spite of these activities the performance of Latin American students is still significantly lower compared to students in other regions. (World Bank (1998) and Inter-American Development Bank (1998).) Therefore, improving the quality of education is a prerequisite for the successful participation in the process of globalisation.

A further challenge for institutional design is the reform of the judicial sector and the bureaucracy being two major preconditions for an economic system based on market principles. The judicial system has to provide a reliable framework for social interaction between individuals in order to foster trade and offer solutions for conflicts. The judicial system in Latin American countries suffers from insufficient financial support, long duration of trials and external influences on the decisions of courts. While we find an average duration of trial of 1500 days in Ecuador and Brazil this measure lasts only 100 days in France. (Schäfer (1998).) A reform of the judicial system should ensure a high qualification of judges, should fight corruption and improve the efficiency of courts. (World Bank (1998).) Moreover several empirical studies show a low performance of the bureaucracy in Latin American economies. Considering the evidence in Peru we even find the public administration undermining the principle of the rule of law by undertaking illegitimate actions. (World Bank (1998).) Nevertheless the example of Chile shows how an efficient and transparently acting public administration can foster the institutional framework for investment and growth. (Marcel (1999).)

Without covering all possible aspect of the problem we showed that despite the globalisation there is still room for national policy. But the state has to adapt to the changing requirements for domestic policy by providing a suitable institutional framework to enhance investment and growth in the long run. Additionally an efficient system of social security will maintain the consensus in society by reducing poverty and reducing the risks of economic activity in a market economy. If the Latin American countries can successfully face these problems they will participate in the global economy and realise gains in welfare for their populations despite their experience during the 80s.

3. Conclusion

For discussing the implications of globalisation on Latin American countries we considered it useful to split the phenomenon in several processes with significant impact on the economic development of the region. Analysing these processes we found them to pave the way for a potential acceleration of economic development and therefore the possibility for the region to catch up with the developed countries. However, a successful participation constitutes a big challenge for the Latin American countries. The first prerequisite for this is a suitable economic policy which improves the educational system and the institutional setting of financial markets as well as it creates a more efficient public administration and ensures social security. Realising these challenges we think that globalisation does not hinder a sovereign economic policy but rather makes it a precondition for economic success. However, globalisation does not only affect the field of economic policy but also implies a challenge for the people in Latin America. Being able to take ones chances and think in terms of competition will in the same time be a necessary condition for a desirable development process. In the long run these two preconditions of the development process have to be simultaneously fulfilled. Offering a suitable policy framework can only lead to desirable results if people accept the challenges and think in terms of a market economy. Looking to the past and present of Latin American societies policy makers have to realise that enabling marginalised groups in society to participate actively in the development process will be crucial for its success in the future. An efficient social policy has to offer equal opportunities for all members of society and assure compensation for the loosers of globalisation. To ignore globalisation or even struggle against its implications cannot be a sensible alternative for the region. Hence, we consider it necessary to continue the reforms making it possible to profit from the globalised world we face today.

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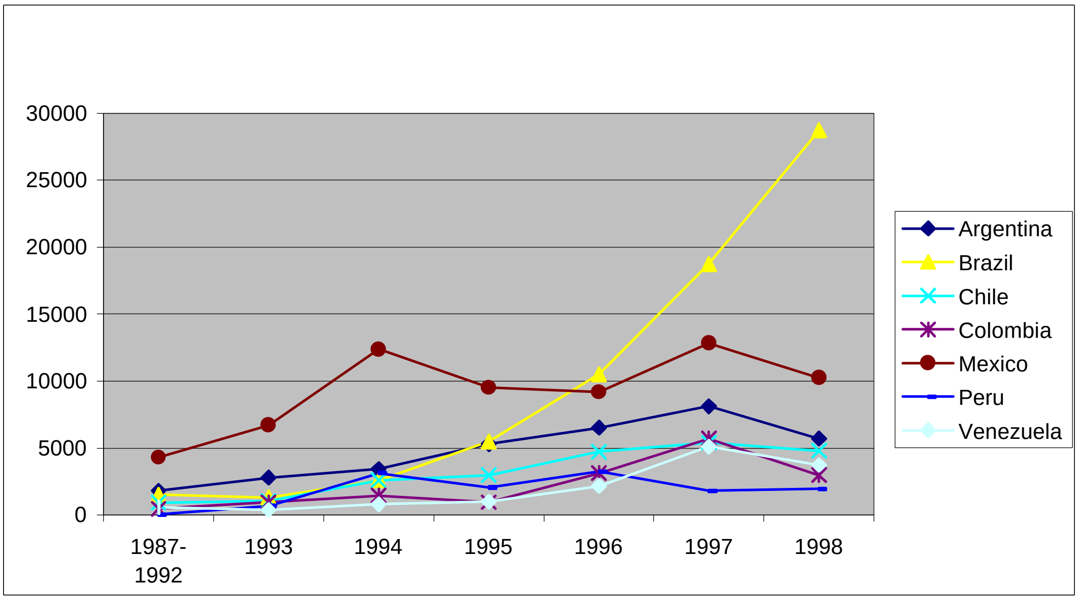
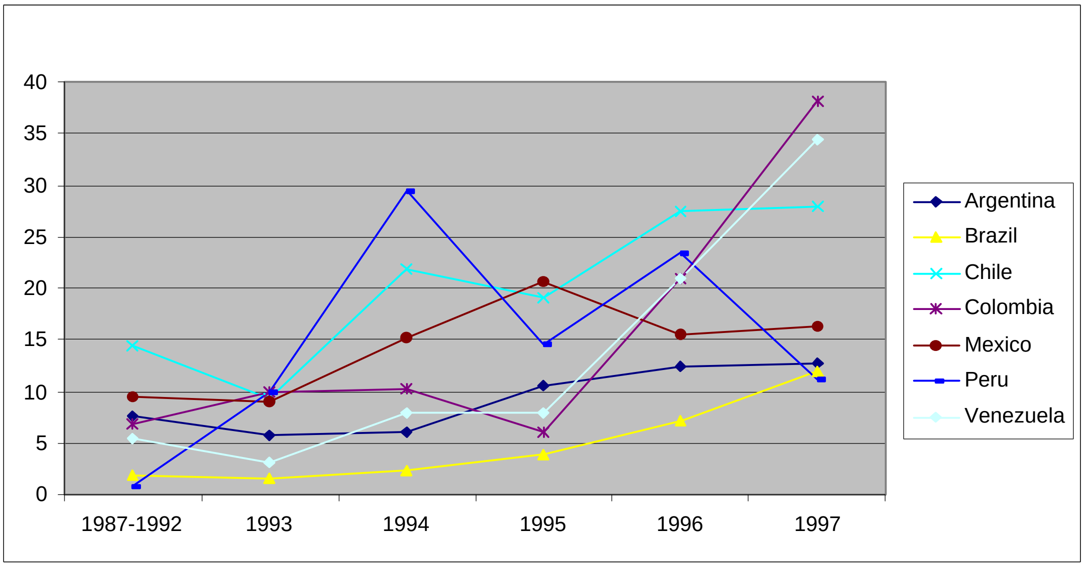
Appendix

Graph 1: FDI – Inflows to Latin American Countries 1987 – 1998 (in mio. US-$)



Source: UNCTAD (1999): World Investment Report.

Graph 2: FDI divided by Gross Domestic Capital Formation 1987 - 1997



Source: UNCTAD (1999): World Investment Report.