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**Globalization and Transformation**  
**Illusions and Reality**

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## **Globalization and Transformation Illusions and Reality**

### **Summary**

The globalization of economic relationships and the systemic transformation in postsocialist countries are two interlacing processes and a mark of the turn of the century. Globalization, that is, the institutional and real integration of national and regional markets into a single worldwide organism, is neither restricted to the last few decades, nor is it, as yet, an irreversible, let alone complete process. Even in its most advanced form it does not prevent nations from conducting an economic policy, whose quality remains essential for economic efficiency and growth rate. In contrast, the market transformation of postsocialist economies and their integration with the world economy along capitalist lines *is* irreversible – precisely because of globalization. The transformation will soon be complete, unlike globalization, because the latter, being a dynamic, open-ended process – has no end, just as there is no end to socio-economic development. For this reason, and also bearing in mind the ongoing fourth industrial revolution spurred by the development of the Internet, the future is bound to bring even greater changes.

# Globalization and Transformation Illusions and Reality

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## 1. Permanent globalization

A great deal depends on the definition. One might argue that globalization began thousands of years ago, with the invention of money and the emergence of trade links uniting the entire world known to the Phoenicians. Gradual expansion of the Mediterranean trade was the first harbinger of what was to materialize – on quite a different scale – in our days. This expansion is going to take even more spectacular proportions in the new millennium, as it is hampered not so much by natural, physical barriers, as by technology, economics and politics. In the old days, the inaccessible world (with its raw-materials supplies as well as markets for products) lay beyond the mountains and seas, rivers and woods; then things started to change: the real barrier to trade was (and often remains) the level of available technology, economic knowledge and lacking political acumen. More often than not, the future was something to be divined, rather than plainly seen. Today its “visibility” seems to have improved, but, looking back, what people could “see” fifty years or a century ago was precious little.<sup>1</sup> And things are hardly different today.

One might likewise argue that globalization is as old as civilization, for throughout the centuries, market economy has not only continuously “deepened”, but also “broadened”. Ever since men moved out of the cave (and later also the village), finally to reach a state when without leaving the office he maintains a constant market presence, the space in which economic activity proceeded incessantly expanded. However, it was a rather sluggish expansion. Several thousands years ago, technology spread at an estimated pace of 3 miles a year (Cohen 1998). Today, by contrast, innovation extends at tremendous speed so that even the countries lagging behind technologically can benefit from the rapid transfer of new production technologies soon after their development or implementation elsewhere.

Globalization lasted throughout the Middle Ages, symbolized by Marco Polo (1254-1324), the illustrious traveler and writer. Although he himself was chiefly interested in getting to know some distant corners of the world (as perceived in those times), his sponsors were concerned with economic expansion, trade development and maximizing returns on capital. It was thus economic globalization they advocated, although no one would have used this term at the time, just like feudalism was never called feudalism while it lasted.

The first major breakthrough in the evolution of economic globalization occurred, as it were, by accident. One of the successive waves of expansion was spurred by the desire to facilitate access to other markets, already known to exist, especially those of the East: Arabia, China, the Indian subcontinent and the Malay Archipelago.<sup>2</sup> The objective of that policy was to reduce transaction costs by cutting down transportation time and finding new sources of raw materials and finished goods. This was followed in due course by the creation of markets for the importers’ own products. All these forms of activity were becoming increasingly important for the prosperity of metropolitan centers and the living standards of their elites. Then, five centuries ago, came the “discovery” of America, which had far-reaching implications for that phase of globalization, since, together with the other fundamental discoveries of the 15<sup>th</sup> and 16<sup>th</sup> centuries, it provided strong impetus for the development processes. Many “emerging markets” thus came into being. But first and foremost,

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<sup>1</sup> History abounds in nonsensical statements: now about its coming to an end, now about the end of technological progress or science. “Everything that can be invented has been invented,” claimed in 1899 the Commissioner of the United States Office of Patents, hinting that this institution was no longer useful and should be abolished (see Economist 2000a, p. 5). Oddly enough, a century later, similar views are still occasionally voiced in otherwise serious writings, asserting that mankind has learnt all that there was to be learnt and, essentially, science has reached its limits. See Horgan 1996.

<sup>2</sup> It is amazing that, 500 years later, those vast regions are still perceived by the West – Western Europe and North America (which back in those years was still awaiting “discovery”) – as “emerging markets”. Apparently, a market may take quite long to “emerge”, just as globalization itself is an extremely lengthy process.

globalization entered the first of its major phases – colonialism, with its most hideous aspect, the memory of which still haunts American capitalism – slavery. Man himself had become a commodity, as a result of which whole new regions, notably Africa, became involved in a rather peculiar fashion in the worldwide economic exchange.

Interestingly, those early “globalizations” did not accelerate in any significant way the growth of per capita income; nor did they improve the living standards of the population at large. Until the 19<sup>th</sup> century, the growth of output in absolute terms was slow. Calculated on a per capita basis, it hardly increased at all until the mid-18<sup>th</sup> century, when technological progress set off a marked upward trend in productivity. Estimates indicate that two hundred years ago, per capita GDP in Western Europe (then by far the most developed part of the world) fluctuated around 1000 dollars (at 1990 prices) – merely double the amount a millennium before. It was only around 1820 that substantial growth began. Currently, per capita GDP in Western Europe (whose population has multiplied over the last two centuries) exceeds 18,000 dollars.

It follows that while output had barely trebled over a period of 1800 years, it subsequently increased almost tenfold in the next two centuries. The economic and cultural benefits brought about by expanding and steadily (albeit slowly) integrating markets were allocated extremely unevenly. These were highly elitist globalizations. Selected, narrow groups of beneficiaries turned the developments to their fullest advantage, while the masses hardly had a chance to enjoy the fruits of globalization. This truth should be kept in mind today, because although history never exactly repeats itself, it always does so to some extent.

For centuries, the world’s population growth was very slow, mainly because of the equally sluggish growth of output, that means, the potential of the economy to sustain the population and its reproduction. Until recently, the Earth did not have many inhabitants and their numbers hardly grew. The world population at the beginning of the Christian era has been estimated at 300 million. This figure had barely changed by the end of the first millennium (ca 310 million), and by the time Columbus discovered America, it had climbed to a mere half billion. Three hundred years later the population of the world hit the one-billion mark – and then it increased by an additional five billion in just two centuries. Over the last fifty years alone, when the present phase of globalization has been gaining momentum, the number of the world’s inhabitants has doubled. During the next five decades – by the year 2050 – it may increase to an estimated 8.9 billion, and the growth will continue to be fastest in Asia.

In the remote past, globalization undoubtedly meant the progress of civilization, but it had its darker sides too, such as three centuries of slave trade, or numerous armed clashes and imperialist wars between colonial powers entangled in conflicting interests. It seems hard to believe that not so long ago the same leading, highly developed capitalist countries which show today so much determination in combating international drug trafficking (which, incidentally, is yet another facet of globalization) waged wars in order to impose narcotics use upon the populations of the then “emerging markets” they had enslaved. The Opium Wars in 19<sup>th</sup>-century China provide a textbook example.<sup>3</sup>

The second major breakthrough in economic globalization came in the 19<sup>th</sup> century. Some authors claim that the qualitative changes it brought were no less significant than during the present phase (Bordo, Eichengreen and Irvin 1999, Frankel 2001). One should not forget that it was at that time – not today! – that output grew and international trade expanded within the framework of a stable monetary system, guaranteed by the gold standard, to be abandoned

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<sup>3</sup> Joseph E. Stiglitz (1998, p. 70) writes that, “It is hard to escape the irony between early drug wars – Western powers trying to keep China open to the flow of drugs – and the more recent equally adamant stands [of the Western powers] trying to stem the flow of drugs into their own countries. Only the lapse of time – and lack of knowledge of these historical experiences – softens what otherwise seem[s] an intolerable level of hypocrisy.”

in the following century. That period made a qualitatively new contribution to the globalization process, not least because of rapid technological progress (O'Rourke and Williamson 1999). Maritime and railway transport advanced; the telegraph was invented; mass production flourished. The epoch was significantly different from the times of the Age of Exploration. The new frontiers of discovery were now technology and economics.<sup>4</sup> It is particularly interesting to note that although all the continents and islands had been reached, and the frontiers of science and technology had advanced to an unprecedented degree, even greater discoveries were yet to come, to be made in a new space of economic expansion (by which we do *not* mean, at least not yet, outer space).

However, much of the 20<sup>th</sup> century was wasted. Not only through two destructive global conflicts, but also in view of various serious frictions that hindered the development of healthy economic relations on a worldwide scale. There was no future, as it turned out, either for the world socialist block, which is about to quit the scene in its hitherto form in the wake of the systemic transformation in Eastern Europe and Asia, or for the worldwide colonial arrangements, which fell apart in a matter of a single generation.

**This does not mean that the demise of the socialist system entails the loss of all the positive contribution it has made to the development of civilization. That would be not only undesirable, but plainly impossible: social solidarity, the craving for more equitable distribution, and the perceived need of rectifying some of the free-market excesses by political means are here to stay.**

Likewise, the symptoms of economic dependence going back to the colonial and neo-colonial periods have by no means disappeared. Quite often it is only their form, but not content, that has changed. This is one of the factors behind the mounting frustration and social protests against globalization, perceived by some groups and circles, and even by entire nations in the process of emancipation, as the old colonial exploitation under a new guise. Both bring about similar results, although by quite different methods.

Finally, the third great breakthrough and qualitative change accelerating the permanent globalization process is in progress right now. An old curse fulfilled, we do indeed live in interesting times. Even very interesting. Nearly everyone is talking globalization these days, although few give it a precise definition, and hence this rather fuzzy concept has many interpretations. We assume here that **globalization signifies the formation of a liberalized and integrated worldwide marketplace for goods and capital, and the emergence of a new international institutional order facilitating the expansion of production, trade and financial flows on a worldwide scale.** What we witness is at the same time one of the many phases of this process and the greatest, fundamental breakthrough on its path thus far. The contemporary changes thus do have their specificity and do exert an impact on reality – not only in economic terms (Kolodko 2001).<sup>5</sup>

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<sup>4</sup> Keynes, not without a certain nostalgia for the 'good old days', made an interesting observation: "What an extraordinary episode in the progress of man that age was which came to an end in August 1914!...The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth...he could at the same time and by the same means adventure his wealth in the natural resources and new enterprise of any quarter of the world..." (Keynes 1920). These are the words of John Maynard Keynes, written 80 years ago, not of Bill Gates from 80 days ago! It is also interesting to note that it was at approximately the same time (the first half of 1916) that Lenin wrote his significant *Imperialism, the Highest Stage of Capitalism* (Lenin 1950). As it happened, both ways of thinking were to exert tremendous influence on the history of mankind (and vice versa) over the time span of the next three generations.

<sup>5</sup> Globalization in other spheres of human activity – especially culture and science – as well as the strictly political aspects of this process, are beyond the scope of the present discussion. It is obvious, however, that many problems related directly or even indirectly to world trade and finance are also aspects of globalization. This is amply illustrated by problems of international organized crime or global warming, which no government or even group of states can tackle single-handedly. Global problems are to be solved by global institutions. The point is such institutions are often lacking, while the number of global problems is increasing.

## 2. Globalization at the turn of the century

In view of the above definition it is clear that globalization was not restricted to the last couple of decades and is still anything but complete. Accordingly, if so much remains to be done, it is not an irreversible process. The risk always remains that the old political or economic divisions and barriers to free trade and unhindered international business will persist or reappear, or even that new ones will emerge. A hundred years ago some people thought that everything had been invented and discovered; others believed that mankind should look forward to nothing but peace and progress. The world's economic history proved them wrong. What then are we to expect now?

Any attempt to answer this question must first explain the causes of the current acceleration of the globalization process and its intensification, the scale of which not only fosters great progress, but also revives certain social and ideological, as well as regional and international conflicts which might have seemed resolved. This will be done along the following lines: globalization dynamics depends on three factors, whose favorable configuration can give it tremendous impetus. Conversely, if one of these elements is lacking – which was often the case in the past and which cannot be ruled out in the future – globalization yields partial, defective, and in extreme cases, abortive results (e.g. wars). These elements include:

- **the character of technological progress;**
- **mature political relationships;**
- **the state of theoretical knowledge and practical economic skills.**

Nowadays these three elements interlock and reinforce one another like never before. It is hard to determine precisely the impact of each of them on the progress of globalization. Various authors differently assess the specific factors, alternately overrating and underestimating their relative importance. It is certain, however, that only an appropriate combination of the three components could have led to the present rate, scope and intensity of the worldwide liberalization and integration of markets.

The fourth industrial revolution is under way, connected with the proliferation of information technology and computerization that affect nearly all the spheres of human activity. This revolution also comprises the advances in biotechnology and genetic engineering, together with the implementation of their findings in industry, which very soon translate into new mass-production technologies. But the most revolutionary development is the expansion of the Internet, increasingly felt in ever new spheres of business activity and the related areas of politics and culture. The Web is changing the world, for it is changing the ways people communicate.

This pertains first of all to the rate of information exchange, which dramatically reduces transaction costs. In 1860, sending two words across the Atlantic cost the equivalent of today's 40 dollars; nowadays, this amount of money would be enough to transmit the contents of the entire Library of Congress. The cost of a telephone call from London to New York has decreased since 1930 by a factor of 1500. The price of computing power has dropped in real terms by 99.999% since 1970 and the only reason it is still included in the calculation of costs is the huge amounts of data being processed.

More and more transactions are being transferred to the Web, both at the 'business-to-business' (B2B) and 'business-to-consumer' (B2C) levels, thus reducing the costs, with the added benefit of stimulating efficiency-based competition. This is an irreversible process. However, in order to reach a scale significant from the point of view of the economy at large, the use of the Internet by the population must reach a certain critical saturation. In the case of electricity, a marked increase of economic growth occurred only 40 years after its

implementation in manufacturing. The Internet spreads much faster and we will not have to wait that long. However, even in the USA, the **“new economy” brought about by the Internet revolution** took off only when computers had made their appearance in nearly half of the households. In other countries, such a saturation level is still a long way off, but the progress is fast. The effects of the Web expansion will thus soon reach other economies, less advanced technologically at the moment.

The Internet exerts an influence on education systems and research methodology; it has an impact on administration and the expanding entertainment industry alike. Its comparison to television would be a false analogy – it should rather be likened to the ability to use the written word. **A century ago, people were divided into those who could read and write, and illiterates; now a similar distinction applies to those with Internet access and skills, and those devoid of these assets.** This is the field where the battle will be fought for greater efficiency and better living standards.

The Internet revolution presents a chance to accelerate growth in all countries, although for the time being they are not equally positioned to take advantage of this opportunity, just like the expansion of railways 150 years ago did not bring equal benefits to everyone. What is needed in the first place is an appropriate infrastructure and the necessary institutions.<sup>6</sup> From the point of view of development strategies, a creative use of the Internet requires development-policy support, for its is not so much a “new economy” that is emerging, but rather its new – fourth – sector.

**Like farming and the extraction of minerals in the old days, and then manufacturing, followed at a later stage by services, so now it is the fourth sector – the Internet economy and modern information technology, crisscrossing all the areas of human activity – that will assume critical importance in the 21<sup>st</sup> century.** While grappling with so many old problems in the traditional sectors of the economy, it is worth keeping in mind that the future will depend chiefly on the fourth sector.

The Internet revolution and the appearance of computer networks – nearly omnipresent in the most developed countries, while their status in less advanced economies remains on the peripheral side – constituted a far more profound change than it would appear from today’s perspective. The Web is resizing the Earth. The world’s dimensions, and hence also the compass of accessible markets, were once limited by geographical and political barriers; today it is no longer possible to shut off, say, the Amazon Basin or Tibet. No place is “too far away” any more. We used to talk about a “shrinking world”, as the time necessary to move, send goods, transfer capital or convey information from place to place shortened. But today, paradoxically, the world has “shrunk” to a point when it begins to expand rapidly.

In many spheres of business activity, the distance barrier and the attendant costs have been totally eliminated. Cheap Internet access allows one to transmit huge amounts of data, practically in real time, between any two places, and at a cost that is negligible in any larger-scale transaction. By the same token, it is possible to provide certain types of services and sell various types of goods – not only books and music, but also a number of other products, from computer software to technology.

In this way, the current phase of the fourth industrial revolution and the explosion of Web technologies, rather than “shrink” the world, have caused its incredible expansion. **The role of the Internet in economic development is similar to that of the discovery of America five centuries ago, because it enriches the “old world” with new expanses of**

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<sup>6</sup> It is a truth often forgotten by market-oriented fundamentalists that the lack of regulation sometimes leads not to progress, but to pathology. Formerly, it took the form of transportation disasters, which quickly gave rise to strict regulations in this area; now it is crime in cyberspace. Whereas in previous 10 years, there were 34,000 cases of unauthorized access to computer systems recorded worldwide (mostly in the United States), in 2000 their number soared to 60,000 – mainly outside the U.S., since nothing globalizes as quickly as the Web.



**economic space in which to do research, invest and reap profit, manufacture goods and provide services, buy and sell, store and consume, teach and learn, read and write.** This is a truly historic change and a very special moment – the third major breakthrough in the permanent globalization process. Enormous amounts of inventiveness and entrepreneurship as well as significant resources of human and financial capital are moving into virtual space, where they find an advantageous environment.

Thus the vision cherished by many a dreamer and scholar, who saw outer space as the target of the next great expansion after the Age of Exploration, did not materialize. Sure enough, it may yet come true, but now is an **Age of Virtual Expansion**. The new space opens up new development prospects, but at the same time creates immense challenges.<sup>7</sup> Like before, not everyone is in a position to take advantage of the opportunities arising in the wake of the latest breakthrough. And the actual gains of the actors involved will also depend on the remaining two factors that determine the shape of the current globalization phase – political relationships and economic knowledge and skills.

The technological revolution alone is not enough to keep globalization going. True, the latter process is capable of overcoming physical barriers and, from this point of view, there will soon be practically no inaccessible places of any economic importance left on earth: there will be no regions where, technically speaking, one could not invest, produce, buy or sell. But **other obstacles remain in the way – political and social borders, cultural and mental differences, trade and customs barriers.**<sup>8</sup> In order to eliminate and overcome these, an appropriate policy is needed. And it is in these fields, too, that revolutionary changes are taking place, reinforced – among other things – by technological progress.

Recently, particularly over the last twenty-five years, political attitudes towards free trade and unhindered capital flows have been shifting. Previously – under real socialism on the one hand and neo-colonialism on the other – less developed countries perceived transnational corporations mainly as an instrument of capitalist exploitation of the Second and Third Worlds by the First World. Now that a “Single World” in the form of an integrated global marketplace emerges, the same corporations are seen as the main source of technology transfer and know-how in the areas of management and marketing, as well as a supply of still-scarce capital. In 1999 alone, international capital flows related to foreign direct investments exceeded 800 billion dollars.

In parallel with the above, there have been massive movements of free capital resources controlled by financial intermediaries which have no direct links with such corporations. These occur mainly between the richest countries, but capitals have also been flowing from developed to emerging markets and, occasionally, in the opposite direction. If,

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<sup>7</sup> It is tempting to paraphrase Keynes in a modern spirit: “How extraordinary this age is we live in! Sipping his morning tea in bed, the inhabitant of the world shifts his investments from the Shanghai Stock Exchange to Moscow with a click of the mouse; in the afternoon he moves them to São Paulo, taking a peek at Bloomberg’s in the process, without even bothering to send the butler for a copy of the *Financial Times*, as everything is available on-line... Meanwhile, he goes through a heap of mail to and from all corners of the world, sending the manuscript of his new book on emerging markets in mere seconds to an addressee thousands of miles away. And all that is provided almost free of charge – for less than the cost of a cup of tea...” It must be borne in mind, though, that it is equally easy to lose quite a bit in the very same way – without getting out of bed – even on long-emerged markets, for instance, by moving one’s capital from Dow Jones to NASDAQ (or the other way round) at the wrong moment...

<sup>8</sup> The belief in the Internet revolution as a motor of progress will remain yet another illusion for as long as cultural backwardness and illiteracy prevail. First you have to be able to read and write and to know English; only then can you take advantage of the riches of the Web, in which more than 95% of information and transactions is transmitted and conducted in English. And yet in such populous countries as India, Pakistan or Egypt, more than half of women and about 40 percent of men are illiterate. Thus to grasp the new opportunities opened up by globalization and the “new economy”, a major breakthrough in the field of education is more needed than ever.

however, direct investments by their very nature enhance the competitiveness and increase output in the recipient countries, this may or may not be the case when portfolio investments come into play. In the face of immature institutions and faulty financial policy, fluctuating levels of portfolio investments may precipitate regional financial crises: witness the occurrences of 1997-99 in parts of Southeast Asia, South America and in Russia.<sup>9</sup>

Political endeavors have also ushered in far-reaching trade liberalization: the development of new technologies alone would not have been enough to achieve this. Worldwide volume of trade has increased more than sixfold in the last two decades and its expansion invariably outpaces by a wide margin the overall growth of output. Worldwide output increased in the years 1998, 1999 and 2000, respectively, by 2.6%, 3.4% and 4.7%, as compared with the trade-volume increase of 4.3%, 5.1% and 10.0% in the respective years. The projected increase of these two indicators in 2001 is, respectively 4.2% and 7.8% (IMF 2000b). If these projections prove right, the average growth of trade volume will be greater by a factor of 1.9 than the output growth over the four-year period (respectively, 6.9% and 3.7%).

Even so, free trade still encounters numerous barriers and obstacles, but it is also gaining an increasing institutional support. The Bretton Woods conference in 1944 stopped short of creating a specialized international agency for the stimulation of free trade – only the World Bank and the International Monetary Fund were established. Half a century later, the World Trade Organization came into being, giving a new impetus to the ongoing liberalization of the international exchange of goods and services. The accession of China and, a little later, also Russia, to this organization – signifying not only progressing globalization, but also the postsocialist systemic transformation in these two countries – will give this process an additional boost.

Finally, the third catalyst of modern-time economic globalization is the level of theoretical knowledge and practical economic skills. This knowledge not only evolves, but also accumulates in time, drawing liberally on historical experience. Mankind has learnt a great deal during the centuries of permanent globalization and this wisdom can now be turned to advantage, as long as technology facilitates this process and politics does not stand in its way.

Modern theory of international trade proves beyond doubt that those economies which show greater openness to foreign economic contacts – trade, financial transfers, capital movements – have a better long-term development potential (Crafts 2000). What remains, on the other hand, a moot point is how to move from a relatively more closed (less open) economy towards greater liberalization of links with other economies and the global system. The experience of recent years has provided various insights into this problem, which are often stated in negative terms, for instance: wrong sequencing of trade liberalization, macroeconomic stabilization and market-institution building resulted in severe depression in postsocialist counties (Kolodko 2000c), or poorly designed structural reforms liberalizing capital flows, implemented without the necessary policy support, brought about a crisis in Southeast Asia (Chan-Lau and Chen 2000). Generally, however, **the crises that erupt from time to time should not be attributed to the liberalization of trade and capital flows alone, but rather to policy errors, in particular, the failure to implement necessary reforms in other areas so as to take advantage of the opening up and integration.**

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<sup>9</sup> According to the estimates of the Washington-based Institute of International Finance and in the opinion of Nikolai Kovalev, Chairman of the Russian Duma's Anti-corruption Committee, about 160 billion dollars was transferred out of Russia in 1991-2000. The outflow of capital at a rate of some 20 billion dollars a year continued in 1999-2000, already when the direct effects of the financial crisis of summer 1998 had been brought under control. See Nikolai Kovalev, "Vniz po tečeniyu deneg" (interview), *Vek* (Moscow), No. 48, December 1st, 2000, p. 4.

The trouble is that the knowledge of short- and long-term consequences of liberalization is fullest among the richest participants in the process. It is simply not the case that the available economic knowledge concerning the use of globalization and aspects thereof as a tool stimulating development brings the greatest advantage to those who especially need to expand, in view of their economic backwardness. By no means: the chief beneficiaries of globalization are developed countries. Consultants from these countries and various international organizations (which, to be sure, do play an important role) – from the IMF to regional development banks – not only provide technical assistance and financial support, but also further the interests of the richest countries. Once again, this is a problem of politics (this time taken globally), which may present an obstacle to the absorption of economic thought. For the science of economics knows the answer to more questions than it can actually apply in order to prove its utility.

### 3. Regionalism and the global market

Despite the significant progress attained during the last three decades, and especially in the 1990s, in the fields of global capital movements and free-trade expansion, the scope of the actual globalization, that is, genuine integration of various, still-existing local, national and regional markets into a single worldwide marketplace, remains marginal. The processes we witness mainly consist in tightening regional integration. Markets typically first integrate between close neighbors, in view of the natural proximity of supply sources and sales outlets, lower transportation and storage costs, as well as common tradition and cultural affinities, including the identity or at least similarity of languages.

On the one hand, if such integration processes fail to occur, this is usually attributable to political reasons, as is the case with the United States and Cuba, Greece and Yugoslavia, or, in the most extreme form, South and North Korea. In our region of Europe, this is exemplified by the trade relations between such neighboring states as Estonia and Russia or, even more to the point, Belarus and Poland. It is indeed odd when the trade volume between two next-door neighbors does not exceed one percent of the total import-export turnover of the respective countries.

On the other hand, market integration may sometimes reach a fairly advanced stage between geographically distant partners, such as New Zealand and Singapore, which have recently concluded a free-trade agreement, or the United States and Chile, which proceed in the same direction. These are still rather isolated cases, but they may be expected to multiply in the future.

The examples of integration involving geographically distant countries at different levels of development, like Australia and Samoa, or even more disparate economies united by their spatial proximity and membership in the same organization, for instance, Malaysia and Cambodia, indicate that regional integration (or just tight bilateral relations) may not be critically dependent on the similarity of output levels or institutional systems. The point is that integration takes various forms and, accordingly, the accruing costs and benefits can be variously distributed between specific classes and social/occupational groups both within and across the nations involved. However, **if increased social differentiation in the aftermath of full integration is to be avoided, matching development levels and reasonably uniform institutional solutions are required.** Thus what matters in the integration process is not so much equal development levels at the outset, as the operation of an equalization process, which clearly necessitates faster growth in relatively less advanced regions. The problem is how to make this acceleration profitable also to the richer partners, or else they would not be interested in any strategic involvement of this kind.

The only fully successful large-scale regionalization process in history was the emergence and development of the United States of America over the past two centuries. After all, it would be possible to imagine what this territory – from Alaska to Florida, from Maine to California, from Louisiana to Hawaii – would be like today, were it still divided between Britain and Spain, France and Russia, the Indians and the Polynesians, and various immigrant groups of European, African and Asian descent, at odds with one another. Where would the world's greatest economic power be today, if there were still many currencies and languages used in its territory? And even with a common language, the use of different currencies has a significant, negative impact, as is aptly demonstrated by the comparison of the volume of trade and movement of capital and population between Washington State and its two neighbors: the American state of Montana and the Canadian province of British Columbia – it is substantially higher in the case of the former. Now if the entire territory of the United States were not a fully integrated economic organism, which it luckily became in the earlier phases of globalization, it would undoubtedly be far less efficient today and could not compete so successfully with Western Europe. The latter has learnt the lesson of history and taken the integration path: the languages remain different, but at least a common currency system is already taking shape.

Regionalism evolves in various parts of the world, but some centers thereof are clearly emerging, from which it spreads, not unlike the ripples caused by a stone dropped into water. North America, Western Europe, Southeast Asia, the southern part of Latin America, Southern Africa – these are the best examples of expanding regionalism at the turn of the 20<sup>th</sup> century. Does its revival contradict the globalization tendencies in the economy? By no means, although the answer will once again depend on the definition. **There is no contradiction between flourishing regionalism and globalization construed as the formation of a worldwide capitalist system encompassing all the regions.** If, however, globalization is understood as perfect openness of the world market, in which the output sold locally at every place is proportional to the contribution that place makes to world production, while the remaining part of demand is satisfied by supply generated elsewhere, then regionalism may, of course, be seen as an obstacle to its further progress.

But then again, it does not have to. It depends on whether the strengthening local economic links – in the fields of investment, manufacturing, finance and trade – increase the relative isolation of a given block from the rest of the world (as used to be the case with the defunct Council for Mutual Economic Aid, also known as Comecon), or, conversely, it is accompanied by or leads to higher forms of integration: not so much between individual states as between groups of regionally integrated economies. This problem is currently gaining importance. In view of the difficulties facing further worldwide-scale liberalization of trade<sup>10</sup> during the subsequent rounds of WTO negotiations (concerning, in particular, agricultural products, financial intermediaries, air transport, telecommunications or construction services), some countries prefer not to wait and press ahead in the framework of their regional organizations (Economist 2000b).

Thus, so to speak, the worldwide ranks are being broken every so often, and in place of a would-be global free-trade area – a non-existent and elusive GFTA (Global Free Trade Agreement) – many smaller organizations emerge and evolve which implement varying levels

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<sup>10</sup> Of course, one cannot speak here of a worldwide scale in the literal sense, since more than 40 countries which belong to the Bretton Woods organizations and the United Nations remain outside the WTO. The IMF and World Bank have 182 members each, whereas the WTO has less than 140, with a number of postsocialist transforming economies still outside its ranks. It is one of the many paradoxes of the political side of globalization and its institutionalization that, for instance, Cuba – hardly a free-trade leader – belongs to the WTO (as a founding member of GATT – General Agreement on Tariffs and Trade – it gained membership automatically on the establishment of the Organization in 1995), while the superpower of world trade, China, even at the beginning of 2001 is still knocking at the door.

of trade liberalization and institutionalize their integration links to various degrees. However, the actual developments (in particular, trade dynamics and its changing geographical structure), as well as negotiations under way and political arrangements concluded (for instance, between North and South America, or Western Europe and Southeast Asia), indicate that **modern regionalism is in a sense a vehicle for globalization rather than a barrier to its advancement**. But to ensure that these processes are mutually compatible and reinforce each other in the long run, further progress of globalization, that is, world-wide regionalism, is necessary. It is, therefore, highly desirable that the WTO negotiations be accelerated and the organization itself be extended to the point where all the countries of the world are represented.

All this indicates there is no contradiction between an integrating world market and regional integration processes, which are gaining momentum. On the contrary, the latter act as a catalyst of the former. This is most vividly demonstrated by the ongoing process in which increasing competition combines with the approximation, interpenetration and progressive integration involving the markets of the world's three largest economic centers: the European Union, NAFTA<sup>11</sup> and Japan, together with their closest trade, finance and investment partners. In all three, the turnover grows fastest (outpacing, not unexpectedly, the growth of output) internally and between a given grouping and its closest economic associates – Eastern Europe in the case of the EU, South America in the case of NAFTA, and Southeast Asia in the case of Japan. Their volume of trade with the other parts of the world, including the remaining two economic centers, grows somewhat more slowly, but still faster than output.

As regards capital flows, these are governed by different, more unpredictable rules, which is connected, among other things, with the impact of huge transfers of purely speculative kind, oriented solely towards quick profits, without any actual direct investment in the productive potential of the target region. Importantly, capital flows – unlike the movements of goods, which belong to the domain of trade relations – are directed mainly to the most developed economies. This means there is far more to be done in this field than in the sphere of international trade itself: it is a market which requires some measure of regulation and relative stabilization, and not just increased openness and full liberalization.

Apart from the European Union – the highest form of transnational regionalism attained thus far and the venue of the most advanced of all the integration processes under way, extending from markets to institutions to policy – many other regional integration organizations are expanding, too.<sup>12</sup> The strength of the economic links between the participant countries varies, as do the actual levels of integration of the capital, labor, goods and services markets.

Many countries belong to several groupings simultaneously, which demonstrates that integration processes unfold in many dimensions and at multiple levels. Such parallel developments may occasionally lead to conflict, but more often than not they facilitate the progress of integration, and hence globalization.<sup>13</sup> The establishment of APEC (Asia-Pacific

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<sup>11</sup> The key member of NAFTA – North American Free Trade Agreement – is the United States. The others are Canada and Mexico. NAFTA has a population of about 390 million and an aggregate GDP exceeding 8 trillion dollars, that is, almost 17,000 dollars on per capita basis. Of course, Mexico brings down this average considerably (as will also be the case after the admission of new members to the European Union, especially ones with large populations and relatively low outputs, such as Poland or Romania). From among non-members, Chile, although it is not a North American country, appears to be closest to admission to NAFTA.

<sup>12</sup> The European Union, like the United States, generates about a quarter of gross world product. It should be noted that the term GDP (gross domestic product) might seem somewhat out of place in this context. The point is, however, that through globalization, some regions – and perhaps, in time, the entire world – will become a single *domestic* market.

<sup>13</sup> Without doubt, conflicts of interest of this kind often arise between China and the United States, which is a factor in delaying the admission of China to the WTO. Another example – illustrating not so much conflict as

Economic Cooperation) in 1989, fostered by the U.S., undoubtedly expressed the desire to promote cooperation in the region in view of the growing interdependencies between the Pacific Rim economies.<sup>14</sup> On the other hand, however, it was a political move on the part of the U.S., aimed at maintaining, if not a dominant position, than at least a balance in the face of the Japanese competition, the rise of China as an economic power (then prospective and now quite real), and the increasing importance and influence of ASEAN (Association of Southeast Asian Nations).<sup>15</sup>

Many regional groupings exist which facilitate contacts between economic units in various national economies, which in this way gradually lose their national character and turn international. They differ in terms of the strength of trade and financial links and the degree to which they institutionalize cooperation. Some of them, for instance, Mercosur in South America,<sup>16</sup> are tightening their integration links; others have merely liberalized to some extent trade in some product groups, as is the case with SAARC in South Asia.<sup>17</sup> Some operate within an elaborate institutional framework, as does South African SADC;<sup>18</sup> others – for

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competition – is the contest for foreign direct investment (FDI). In 1996, China attracted some 40-billion-dollar worth of FDI, and ASEAN – about 30 billion. In 1999 China managed to maintain the attained level, while in the ASEAN region it was down to 16 billion dollars. The reason is that China succeeded in taking over part of the flow of long-term surplus savings from other parts of the world, diverted from Southeast Asia in the aftermath of the financial crisis of 1997-99.

<sup>14</sup> Upon its establishment in 1989, APEC had 12 members: Australia, Brunei, Canada, Indonesia, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore, Thailand and the United States. In 1991 these were joined by China, Hong Kong and Taiwan, in 1993, by Mexico and Papua New Guinea, and a year later by Chile. In 1998, Peru, as well as Russia and Vietnam became members. Such are the twisted paths of globalization that, at the time APEC was being formed, the two last-mentioned countries participated in the integration process within the Comecon framework, and now they meet on quite a different forum. The most interesting thing is that even when history takes an unexpected turn, old links may sometimes facilitate the formation of new ones.

<sup>15</sup> ASEAN was established as early as 1967 and originally had only five members: Indonesia, Malaysia, Philippines, Singapore and Thailand. Brunei joined the Association in 1984, Vietnam in 1995, Laos and Myanmar (Burma) in 1997, and Cambodia in 1999. With the exception of the last three, extremely underdeveloped economies, the remaining countries are also APEC members. The ASEAN region has a population of half a billion, but its aggregate product is less than a tenth of that of the United States or EU. However, this grouping is far more open to foreign contacts – not only because it includes the export-oriented Singapore economy – and is therefore more advanced in the globalization processes and their stimulation than other regions. ASEAN's trade turnover is more or less equivalent to its GDP and amounts to nearly 800 billion dollars.

<sup>16</sup> Mercosur is also referred to – not without a certain measure of exaggeration, but not without reason, either – as the Southern Common Market. It was established by Argentina, Brazil, Paraguay and Uruguay in 1991. Chile was admitted in 1996 and Bolivia in the following year. The total population of these six countries is 240 million and they generate a GDP of about 1.4 trillion dollars, that is, almost twice as much as ASEAN, but still almost six times less than the United States. What is more important from the globalization point of view, however, is that the region's trade turnover recorded a sixfold increase in the past decade, which was more than in any other large integration grouping.

<sup>17</sup> SAARC (South Asian Association for Regional Cooperation) was established towards the end of 1985 by a group of seven South Asian countries: Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. It is interesting to note that, despite the still relatively low level of integration, considerable disparities in the development level and cultural differences between the members, the Nice EU summit in December 2000 served as a pretext for an on-line debate, organized on the initiative of the BBC World Service, concerning the question of whether the European Union provides a suitable model to imitate in further integration of that grouping. Far-fetched and premature as this parallel may seem – witness the backwardness of Bhutan vis-à-vis Sri Lanka or the political and military conflict between India and Pakistan – one must not forget that European integration in its present form would have appeared an illusion not only 50, but even 15 years ago. And yet it was a compelling vision.

<sup>18</sup> SADC (Southern African Development Community) includes only 14 from among the continent's 57 countries and territories (Angola, Botswana, the Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, the Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe), which, however, generate more than a half of African output, its greater part coming from South Africa.

example, CEFTA in Central Europe<sup>19</sup> – do not even have a postal address. They all, however, promote globalization through the integration of markets, partial though it may be and limited at the present phase to the regional scale.

APEC and ASEAN are two groupings (which, incidentally, differ considerably in their goals, degree of institutionalization and strength of internal links) that can be invoked in support of the claim that globalization is not too far advanced and proceeds mainly through the fusion of regional markets. Geography and geopolitics still do play a part here. But it is also true that the current tendencies in the field of technological progress, as well as political considerations, extend the scope of integration onto ever larger regions. Therefore, the subsequent rounds in the long-lasting globalization process will bring together the more deeply integrated regional markets: NAFTA with the European Union, APEC with SAARC, Mercosur with SADC, and, most importantly, everyone with everyone else in the long run.

So far, however, trade has focused around three major centers: the European Union, the U.S., and Japan. By way of an example, as much as 76% of Mexican imports come from the United States. In the Czech Republic and Hungary, some 65% of imported goods originates in the European Union, and only less than 5% in the equally large U.S. market. Mexico, in turn, buys only about 10% of imported goods from the European Union and a meager 4% from Japan – as it happens, its trade partner from across the ocean in the framework of APEC. By contrast, the ASEAN member states, as well as China and India, show much greater diversification of foreign-trade markets, on both the import and export sides. Seen in this perspective, these countries are more “globalized” than, say, France or Canada, to say nothing of Poland or Ukraine.

This has serious implications for further evolution of globalization, which is indisputably going to depend to a great extent on tight and full integration of these three huge markets, which generate between themselves nearly 60% of the world’s total output. But **this kind of integration is not to be expected until the international monetary system has been thoroughly remodeled.** The reasoning that led to the birth of the euro, the single European currency, applies here as well. Robert A. Mundell, the Nobel Prize winner in economics in 1999, is certainly right when he suggests that a monetary union should be established between these three areas, as this would provide a major stimulus pushing globalization to a qualitatively new level (Mundell 2000). This is the way the wheel of history turns. There was a time during the earlier stages of globalization when a single world currency did function – quite efficiently at that – in the form of the gold standard, but now this issue reappears in a new light (IMF 2000c).

Yet before a single world currency is established (which is going to be both a logical consequence of globalization and a catalyst providing positive feedback for it), the leading states and economic groupings will have to coordinate their monetary policies and intervene in the operation of the existing currency regimes through organizations established to this end, especially the International Monetary Fund – now in need of a major overhaul. The IMF is not in a position to play the role of a global ministry of finance, for which there is no need anyway, but it will have to cope with the problems of maintaining liquidity on an international scale and a relative stability of the principal world currencies for as long as no single currency

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<sup>19</sup> At present, CEFTA (Central European Free Trade Association) has seven members with a total population of about 100 million. These include: the Czech Republic, Hungary, Poland and Slovakia (which concluded the agreement towards the end of 1992), as well as Slovenia (since 1996), Romania (since 1997) and Bulgaria (since 1999). Five more states consider joining or have already formally applied for membership: Croatia, Estonia, Latvia, Lithuania and Ukraine. In terms of their share in world trade, all these countries are of marginal importance; however, they should be seen as future members of the European Union, to which they are likely to accede with rapidly growing potential and a capacity to improve international competitiveness.

exists. The establishment of such a currency does not belong any more to the realm of pure illusion, but still remains a fairly distant prospect.

The hitherto experience is somewhat puzzling, as the tendency prevailing in the past century went in the opposite direction, leading to a proliferation of national currencies. Initially, this was a result of the breakdown of the colonial system, when nearly all the newly emancipated states began their independent existence with the introduction of national currencies;<sup>20</sup> then, during the past decade, as many as 21 new currencies were established in postsocialist countries (15 in the former Soviet republics, five in former Yugoslavia and two in former Czechoslovakia), while merely three left the scene (the Soviet ruble, the Yugoslav dinar, and the Czechoslovak crown). Thus, in spite of globalization, by the end of the 20<sup>th</sup> century there were more than 130 national currencies in circulation – several times as many as at the beginning of the century.

Thus, depending on the definition adopted and interpretation followed, it is possible to claim that **globalization is still at an infant stage and even the highly developed economies, most deeply engaged in this process, are only at the beginning of the road.** Such a skeptical view can be justified in both economic and political terms.

Jeffrey Frankel maintains that full globalization should signify that the Americans buy, in proportion to their total purchases, a fraction of foreign goods corresponding to the share of foreign manufacturers in global output. The above means that, if the U.S. accounts for about 25% of world product, then as much as three quarters of the goods the Americans buy should be imported. However, the contribution of the U.S. to global trade stands at a mere 12%; it thus follows that full globalization would require an approximately sixfold increase of America's foreign-trade volume (exports and imports), to reach a level when the Americans spend on foreign goods a fraction of their incomes equivalent to the share of the aggregate foreign output in global production volume. The author concludes: "We are still far from perfect openness: the share of output sold at home is disproportionate to the domestic market's weight in the world economy... In other words, globalization would have to increase another six-fold, as measured by the trade ratio, before it would literally be true that Americans did business as easily across the globe as across the country."<sup>21</sup>

This is highly questionable logic. With few exceptions, such as Hong Kong and Singapore, most economies are oriented towards purchasing domestic, rather than foreign goods. Many factors come into play here, but it is chiefly the very same and simple reason which accounts for the tremendous popularity of locally manufactured products in California, while the remaining 49 states contribute, in relative terms, much less to the sales volume in California than they do to American GDP. And yet this does not in the least change the fact that both California and New Hampshire – or, for that matter, any other state – are

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<sup>20</sup> It is an interesting and important fact that the former French colonies in Africa have always retained in circulation quasi-national currencies, pegged first to the French franc and then, consistently, to the euro. In this way they have shifted from colonial dependence to tight links with the new currency of uniting Europe, circulating in an ever-expanding, integrating market. It may not yet be perceived, but links of this kind signify the integration of the economies of, say, Bulgaria and Gabon, or Estonia and Cameroon. This too is an outcome of globalization, which has many dimensions and many faces, some of them quite astounding.

<sup>21</sup> See Frankel 2001, pp. 6-7. Were this interpretation to be applied to Poland, it would mean that in a world of "perfect openness" and "complete globalization", the Poles would have to keep the proportion between domestic and foreign goods and services they buy in line with Poland's share in world output. Thus, if Poland accounts for a mere 0.6% of global GDP, it would have to increase the imports 3.5 times and exports 6.5 times. Under the present circumstances, in 2001, this would translate into both exports and imports at a level of about 150 billion dollars, that is, a total turnover in the order of 300 billion dollars, compared with a GDP of about 150 billion (in 1999 dollars). This is hardly necessary and even less feasible. All that is needed is that the volume of foreign trade should increase significantly faster than overall output, and the dynamics of exports should surpass that of imports.



indispensable parts of the “Americanized” U.S. economy, fully integrated with the other states.

The scope of this “Americanization” – attained over many years through the use of a single currency and language, reliance on common institutions and a single commercial law, the coordinating function of the federal policy and common foreign policy – is full. On a worldwide scale, however, “full globalization” in this sense will never be achieved. Not that it is even worth pursuing. What can be a plausible vision of an integrated Latin America towards the end of the present century or a united Europe at some likewise remote time in the future, is an illusion when applied to the world at large. Globalization defined in this way would mean, from a certain point, *decreased* rather than increased efficiency, which would be an absurd outcome.

**The limits of globalization are defined by the limits of efficiency gains and the economies of scale to be achieved through continued expansion of markets and deepening of their integration.** One can advocate full, omnipresent democracy, and yet it would be foolish to demand that a global parliament be established through an equal, general, direct worldwide election; by the same token, there is no point in invoking some supposedly ideal, global market, even as a reference point. **The ideal global market is a multitude of markets, smoothly functioning in perfect harmony with one another, in various parts of the globe, just like ideal democracy means the triumph of democracy in all countries.** Of course, even this vision is unattainable, but it is certainly worth pursuing, to be asymptotically approximated.

Seen in this perspective, some markets will remain forever distant. An absolute, perfect openness without any reservations is precluded by the transportation costs or the tariffs and other barriers to trade that persist even in the most liberalized economies, but it is not the only reason. Another essential aspect consists in the fact that today’s world remains, despite the progress of globalization, a world of many currencies and (sometimes) irrationally fluctuating exchange rates which discourage many a participant from exploring other sections of what is supposed to be one and the same market. It is a world of many different cultures and persistently divergent value systems – and it will remain so in the future.

All this goes to show that there is still much room for progress as regards the scale of product- and capital-market integration, which can and should be facilitated by a wise, liberal trade policy – but it also means that integration will never be full. Cultural and psychological factors will likewise continue to play a considerable role, whose importance should not be underestimated even in the most rational of the worlds – to say nothing of the real world we live in.

#### **4. A global market without a global government**

One is tempted to ask: if national markets function within the framework of nation states, then perhaps, by analogy, a worldwide market might fully develop only when some kind of a worldwide state has been established? By no means. To expect the emergence of such a political organism, or to postulate its creation, would be to harbor not just another great illusion, but one more irrational utopia.

Obviously, this is once again a matter of definition, for one might assume that globalization inevitably implies the emergence of a global state with all its fundamental functions, as well as a global government with a ministry of finance. On such an extreme definition, the global government would have the prerogative to exercise the worldwide redistributive function, that is, to levy and collect taxes and to decide about public spending.

However, globalization does not proceed in this direction and it is almost certain that it never will.

The above is not to be taken to imply that the success of globalization and its further, relatively trouble-free evolution is not contingent on working out a political modus operandi and a suitable institutional framework serving the needs of the redistribution of world product along different lines than today. **Globalization stands no chance of total success, because it will be unable to win the political support of the inhabitants of the world (to speak of a “world community” would be premature) as long as the redistribution channels operate like before. What is necessary is worldwide institutions and a worldwide policy and strategies to rectify the global redistribution system that has evolved thus far.** Details and technical aspects will need to be discussed, but further globalization will at any rate require the redistribution of part of the income from the richest to the poorest regions and countries, the way it is supposed to happen within national economies with respect to the richest and poorest individuals and strata. Therefore, there is a **need for a global system capable, in the political and technocratic sense, of transferring a certain fraction of income from places where it is generated in abundance to places where it is necessary to ensure the smooth financing of reproduction and growth processes.**

At present, however, despite the recommendation of the United Nations advocating the transfer of 0.7% of GDP from rich to poor countries, the actual flow barely reaches 0.24%, part of which is being appropriated by various organizations and experts intermediating in the transfers, even though their services may not always contribute to an increased national income in the countries to which the transfers are nominally addressed. Thus in actual fact, it is at most 0.2% of the GDP of rich countries that reaches poor ones through these channels. Accordingly, one should postulate the increase of this ratio to at least a full 1% and the creation of an appropriate institutional framework to redistribute these funds with a view to financing sustained socio-economic growth in the less developed parts of the world. All the phases of globalization up till now have failed to address this problem properly.

And yet it is unacceptable in the long run that some should amass riches, while others are getting poorer and poorer – sometimes in absolute terms, although more often only comparatively – and this too is a consequence of globalization. No lasting acceptance is possible, either, of a situation when privatization and denationalization, conducted with a significant involvement of foreign capital (as in parts of Latin America in the 1980s or in some postsocialist transforming economies, especially Russia, in the 1990s), fail to bring about the absorption of foreign savings and to finance development, leading instead to the flight of capital to richer parts of the world. Nor can it be accepted in the longer time span that speculation on the liberalized financial markets drains the savings of domestic enterprises and households from poorer to richer countries.

It is true that the 20<sup>th</sup> century witnessed a qualitative increase of income in nearly all sectors of the world population. But attributing this growth to the present phase of globalization is yet another illusion. As it happened, the expansion of output and income was fastest in the wake of the previous stage of globalization at the turn of the 19<sup>th</sup> century; secondly, it was stimulated from the 1950s to the first energy crisis, which erupted in 1973,<sup>22</sup> by the rapid growth of socialist and post-colonial economies. Thus world economic growth in the previous century was fastest in its third quarter, when per capita GDP, despite the rapidly

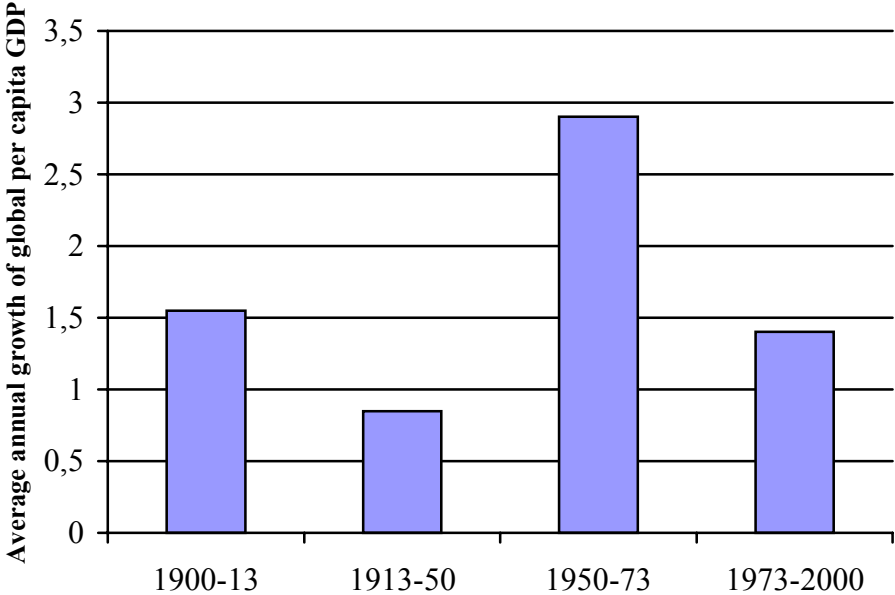
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<sup>22</sup> The energy crisis of 1973-77 was, by the way, one of the turning points of globalization. It changed for good the relative position of many economies, depending on their reliance on the export and import of fuels. If, however, this change had a beneficial long-term effect on the economies of countries rich in oil and natural gas – for instance, the Arabian states, Venezuela, Indonesia or Russia – its benefits for countries whose development strategy had been largely based on coal – like Australia, Poland or South Africa – were short-lived. This was due to the characteristics of technological progress and the increasing social concern about environmental protection.

expanding world population, increased on the average by nearly 3% a year. In the last quarter of the century, the pace of development dropped by more than a half, to a miserable 1.4% annually (Figure 1).

Figure 1

### Global output growth in the 20th century



Source: IMF 2000a.

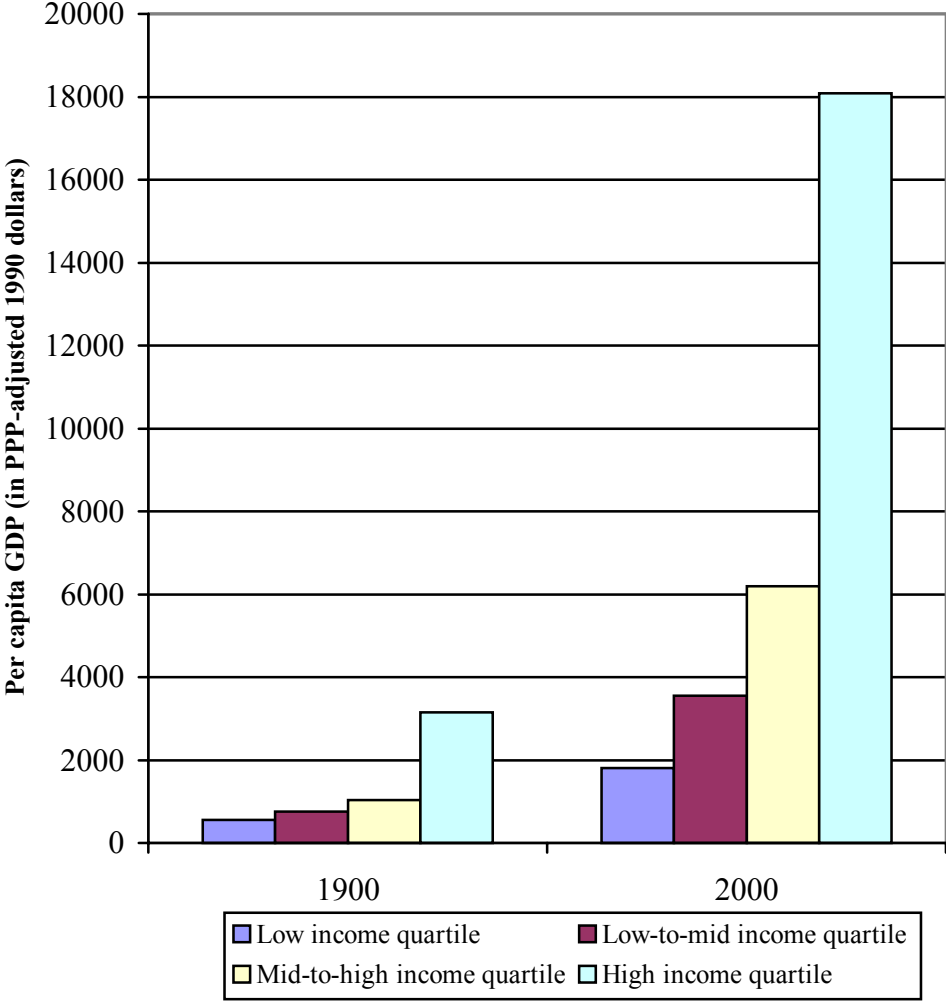
Owing to rapid economic growth in the 20<sup>th</sup> century (let us reiterate, the fastest ever achieved by mankind so far) and the changing proportions of the steadily, if unequally, increasing income, the relatively poorer population groups at the end of the century are not only qualitatively better off than a century ago, but also in many cases they have attained higher living standards than those enjoyed a hundred years ago by groups seen at that time as richer.

Surprising though it may seem, it is a fact that, calculated in terms of purchasing power parity, the average income in the second quartile of the world population (the next-best-off quarter of the population, using the criterion of average income) in the year 2000 is more than two times higher than the average income in the richest quartile in 1900. At the same time the average income in the first quartile is now several times higher than a century ago. As a result, even though the material situation of the second-quartile population has dramatically improved (an increase of the average income from about 1,200 dollars in 1900 to about 6,000 dollars in 2000), its distance from the first-quartile average did not shrink, as the income of the richest 25% of the world's inhabitants has soared over the same 100 years to about 18,000 dollars. The world economy has so expanded that the average income in the poorest quartile now exceeds one half of the average income in the richest quartile in 1900,

which demonstrates the giant leap achieved by mankind over the past century in terms of economic growth, although many people fail to realize its scope fully or at all<sup>23</sup> (Figure 2).

Figure 2

**Income levels at the beginning and end of the 20th century\***



\* The population of every country has been ascribed to a specific quartile in accordance with per capita GDP of a given country. Each quartile corresponds to 25% of the world population.

Source: IMF 2000a.

Thus a large proportion of the inhabitants of the world do not feel they owe such an increase of income to globalization; just the opposite, their frustration is mounting. The reason

<sup>23</sup> It may also happen that people assess their relative material status as much higher than it really is. In the U.S., for instance, as much as 19% of the population believe they qualify to the top 1% of individuals with the highest incomes; this phenomenon is quite interesting psychologically.

is that the number of the poor is hardly dwindling: in absolute terms it has greatly increased over the past hundred years. Currently, 1.1 billion people – nearly a fifth of the world’s population – live on less than a dollar a day. Besides, income disparities have drastically increased over the past century. Income diversification continues at a time of unprecedented acceleration of globalization, which evokes natural associations between the two, although poverty and drastic inequalities in income distribution have many reasons, some of which have nothing at all to do with globalization: for instance, the corruption of the ruling elites or local armed conflicts.

In 1960, when socialism thrived, colonialism disintegrated, and the highly developed capitalist world had to cope with that situation somehow, per capita GDP in the 20 richest economies in the world was 18 times higher than in the 20 poorest countries. By 1995, that ratio had more than doubled, to reach a staggering 37 (World Bank 2000). It is even higher now and may well have exceeded 40. It means that, **a number of factors, including globalization, are pushing up incomes, but there is an even faster growth, likewise spurred by an entire cluster of causes – including, once again, globalization – of inequality and unfair income distribution.**

It is also true that, were it not for the present stage of globalization, the wealth of nations would not be that great, but then many poor countries would not have run into debt they are unable to repay. Undoubtedly, this debt would not have arisen, had it not been for the incompetent policies and inefficient market institutions and democratic structures of the debtors, who, instead of using the funds to finance development through investment in infrastructure and human capital, often waste them on armaments and propping up corrupt regimes. Incidentally, military spending has been and remains useless from the point of view of the debtors, while for the creditors, the borrowing has often served to boost their own defense sectors. Little has changed in this respect, and the only new aspect brought in by globalization is that it embraces the armaments market, too, although – and not without reason – it operates here on slightly different principles, as some countries are free to buy and sell weapons as they please, while others are denied this freedom for political reasons.

As regards the debt of the poorest countries, it will have to be canceled – not only for humanitarian and social, but also economic and purely technical reasons, since it is simply unrecoverable. It is only recently, mainly thanks to the efforts of such international nongovernmental organizations as Jubilee 2000 or Oxfam, rather than any enlightened action of the creditor governments, that an opportunity has arisen for a radical change and a substantial reduction, if not total cancellation, of debt in the so-called HIPC group.<sup>24</sup> Without such a move, several dozen countries that make up this group will not stand any chance to participate in globalization in a profitable and creative way; instead they will perceive it – rightly! – as a modern instrument of their exploitation by the richer part of the world, which is not as mature and integrated as we would like to believe it to be.

Let us note in the passing that **the expansion of many international nongovernmental organizations (NGOs) is likewise a new and important aspect of globalization at its present phase.** Unlike international governmental organizations, they are rapidly expanding their activities, totally independent of the governments and inter-government agreements; at the same time they resolutely resist the pressure from

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<sup>24</sup> Highly Indebted Poor Countries (HIPC) comprise as many as 41 states with a total population exceeding 600 million, most of them living in poverty. These are predominantly African countries, with only four in Central and South America and three in Asia. Merely two of these are postsocialist countries. HIPC include: Angola, Benin, Bolivia, Burkina Faso, Burundi, Cameroon, the Central African Republic, Chad, Congo, the Democratic Republic of Congo, Ethiopia, Gambia, Ghana, Guinea, Guinea-Bissau, Guyana, Honduras, Ivory Coast, Kenya, Laos, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nicaragua, Niger, Rwanda, Sao Tome, Senegal, Sierra Leone, Somalia, Sudan, Tanzania, Togo, Uganda, Vietnam, Yemen and Zambia.

multinational corporations. A new partner has thus entered the global scene, whose importance will quickly grow. In some matters – environmental protection or debt-reduction for the poorest are a case in point – global NGOs are becoming an increasingly powerful ally of social progress. Skilful use of the independent media and the Internet will allow them to exert ever greater influence.

We have seen that the development of the global economy proceeds without a global state, government and a single, globally coordinated policy. But even without all these, various disturbances, as well as worldwide and regional crises, do arise. Unmanageable debt is mounting both in poor countries, like Mozambique, and in resource-rich economies, like Russia. Opportunities are being wasted for a more efficient allocation of resources worldwide – a problem which the market mechanism itself will not solve without external intervention. Worst of all, inequality and injustice are on the rise. The world will inevitably have to respond: either in an evolutionary, or a revolutionary fashion, which signifies, planned and coordinated versus desultory and chaotic action.

But let us notice, too, that despite the existence of states and governments, national economies are likewise crisis-prone and susceptible to disturbances that interfere with their reproduction processes. They too exhibit inequalities of distribution, while social injustice has hardly been eliminated. And so it may happen that the world economy is developing nicely, although no one controls it, whereas some national economies are beset with trouble because they happen to be mismanaged at the moment. Or it could be that the world economy is in trouble, because of the lack of global economic coordination, while a certain national economy is doing fine, because it happens to be run by an apt government. In both cases, the factor or key importance is politics, which signifies coordination and institutions. The worldwide market may thus develop without any state framework to organize its activity and without a world government, just like the worldwide trade develops without a world minister of commerce. What is more, the absence of a global state does not in any way hamper such development, because, on the one hand, the autonomous economic processes are allowed to unfold spontaneously, following their inner logic, while, on the other hand, there is no bureaucratic corset to stifle the expansion of market relations.

However, one must not jump to the conclusion that continued prosperity, in the form of high-quality economic growth and trouble-free expansion of the world economy – which unites ever more tightly through various economic and financial links some two hundred national economies and ten or twenty significant groupings, trade agreements and integration-oriented organizations – will be possible without fundamental changes in the present international institutional order. **What is required by further progress and equitable distribution of the fruits of globalization is not a world government, but a global policy, as well as the coordination of regional and national policies, that is, a suitable institutional framework that provides for an adequate response and for the coordination of various aspects of financial, trade, environmental and social policy.**

Thus the globalization problem has an obvious political dimension, too. Such is the makeup of the modern world that further progress of certain strictly economic processes will be slowed down or arrested without suitable supranational decisions and structural reforms embracing nearly all the world.<sup>25</sup> To illustrate the problems arising in this field, let us mention the inconclusive results of the meetings intended to prepare the next, so-called Millennium round of liberalization within the framework of the WTO; the spurious changes of the

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<sup>25</sup> The qualifier *nearly* is still used here; however, it is next to impossible to hide anything from the rest of the world these days. When globalization was at an early phase, it was possible to remain isolated from worldwide trends – be it for geographical reasons, as in the case of the Congo Basin, or due to cultural factors, as in Japan before the Meiji period. This is no longer possible, whether in Irian Jaya or in Rwanda, for both political and economic reasons. One man's affairs are gradually becoming everyone else's affairs. This too is globalization.

international financial order proposed in the context of the old Bretton Woods structures, subordinated mainly to the interests of the G-7 countries; or the half-hearted resolutions made by the EU summit in Nice in December 2000, failing to meet the scope of the challenge. All these constitute different aspects of the international institutional order which all come together in the single dominant theme of the modern changes – globalization.

The global market calls, therefore, for a global policy which, in turn, requires that a certain critical mass be reached in the sphere of worldwide institutionalization of economic policy. This goal is still a long way off, but the progress achieved so far must not be underestimated. In the absence of such institutionalization, more and more problems will arise every so often, as it turns out that an increasing number of issues require global-scale regulation, while no organization exists capable of preparing, implementing and then enforcing compliance with such regulations on a worldwide scale. Problems are already mounting both in regional contexts (e.g. with respect to the harmonization of taxes in the European Union) and globally (e.g. with respect to the prevention of the greenhouse effect).

Globalization has an unprecedented number of advocates today. This pertains not only to economists, but also to politicians and some circles of intellectuals. In some measure this is a backlash against the excesses of the previous epoch, going in the opposite direction. Isolationism and xenophobia, nationalism and protectionism, parochialism and provincialism are out of fashion today, not least because many people have learnt the hard way that such attitudes bring more trouble and woe than success and joy. This lesson has also been learnt by some closed (or just relatively less open) societies, which found out that was the reason why they were falling behind and missing an opportunity given only to those who join in the opening, give-and-take, interpenetration and integration. Such observations and sentiments significantly affect the emotional and intellectual approaches to globalization, not only on the part of the political elites, but also broader social circles. In fact, under the conditions of greater openness and integration through the exchange of ideas, information, knowledge, experience and goods, the very notion of elites erodes or, to put it differently, its scope greatly expands. As a result, increasing numbers of discerning, active people express their support for further opening, and hence, essentially, for globalization.

Of course, one should be careful to avoid the opposite extreme, for globalization is accompanied by harmful developments and pathological phenomena, too, stirring up ever more vehement protests, ranging from intellectual dissent to street riots. These are provoked not only by the above-mentioned mounting inequality and disparities in the distribution of wealth (resources) and income (flows), but first and foremost by the hypocrisy of the policy response to these processes and phenomena. It is, therefore, conceivable that **the rise and spread of anti-globalization sentiments will send a message that, if heeded by the still somewhat ineffectual architects of international policy, finance and trade, might bring about the best outcome possible: rather than to interrupt or reverse the globalization process, with a detrimental effect on the development of mankind, it might set it on the optimum course.** We do not need a world government to achieve this. What we do need is wise, worldwide coordination of economic policy. And this is the greatest challenge of the 21<sup>st</sup> century.

## 5. Postsocialist transformation

**The postsocialist systemic transformation is a historic process of gradual transition from centrally-planned socialist economy based on the domination of state ownership and bureaucratic regulation to capitalist free-market economy based on the domination of private ownership of the means of production and on liberal deregulation.** It is an

incredibly complex process, which depends on and has a bearing on factors of not only economic, but also social and political significance (Kolodko 2000a). Economically, **the transformation consists of three parallel, interconnected processes:**

- **liberalization and macroeconomic stabilization;**
- **institution building;**
- **microeconomic restructuring.**

Only when these processes take place in an integrated fashion (which implies they should be more or less concurrent) do we witness a systemic transformation, that is, the abolition of the old system and its replacement with a new one. Contrary, when only one or two of them occur, it is merely a reform of the existing system, which it does not seek to abolish. Just the opposite, through the enhancement of its economic efficiency it intends to win popular support for the system and hence to preserve it. Such an approach was once adopted in Yugoslavia, then in Hungary and Poland, and also during the final years of the Soviet Union. This was all before 1989, which was generally perceived as a turning point in history, although the roots of the profound systemic changes often reach much further back into the past.<sup>26</sup>

What is more, the earlier reforms of the socialist planned economy largely account for the future course of the transformation process, with respect to both institutional restructuring and the real sphere. The relatively better results achieved in the first decade of the great transformation by some countries – for instance, Hungary or Slovenia – are largely attributable to the earlier reforms that implemented makeshift market arrangements within the framework of the former system. In Poland, the reforms of the 1970s and, especially, 1980s, significantly facilitated the subsequent transformation. Owing to them, the period of transitional recession was relatively short, despite the serious conceptual flaws and implementation errors in the early 1990s. The recession lasted a mere three years, and some market mechanisms began to operate in Poland earlier than in other postsocialist countries which had not undertaken reform, for instance, former Czechoslovakia or Bulgaria.<sup>27</sup>

The transformation can be analysed at various levels and from many points of view – also in terms of continuity and change in the evolution of the system.<sup>28</sup> Let us note that the term “systemic transformation” is not applied to the development of the capitalist system from the early years of the 20<sup>th</sup> century – when Keynes perceived it as an increasingly efficient worldwide market, while Lenin saw in it ever greedier imperialism – to the beginning of the 21<sup>st</sup> century, when we all view this system in a globalization perspective. And yet these “two capitalisms” are worlds apart, the transition from the one to the other being of a qualitative nature. The reason is that these transformations have come about in an evolutionary way, with the element of continuity clearly prevailing over change – despite such intervening shocks as

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<sup>26</sup> Retrospectively, a tendency becomes apparent to simplify history and identify transition dates with the coming or going of some person or arrangement, which may or may not adequately and accurately reflect the actual inception of a given “major change”. Especially in the West – but also in the East, under the West’s influence – there is a penchant for “political dates” associated with the coming into power of certain forces or individuals, perceived – rightly or not – as responsible for certain changes. Thus it is often assumed that central planning began in Russia already in 1917, whereas in reality it was not introduced until 1929, or that the New Deal in the U.S. goes back to 1933, although its implementation began in fact only in 1935.

<sup>27</sup> GDP shrank in Poland for about three years – from mid-1989 to mid-1992 – dwindling during that time by nearly 20% in real terms. It was mainly caused by an overshoot stabilization policy, a wrong sequence of trade liberalization, and disregard for the impact of the institutional aspects of systemic change on real processes. The consequences of these errors had to be painstakingly rectified in subsequent years (see Kolodko and Nuti 1997). The International Monetary Fund also takes a somewhat different view then before on the influence of those early reforms on the further progress of the transformation (see IMF 2000b, Section III).

<sup>28</sup> For assessments of the progress of the transformation process, see World Bank 1996, Kolodko 1999, IMF 2000b and Stiglitz 1999. As regards attempts at theoretical generalizations concerning the economic aspect of this process, see, among others, Lavigne 1995, Blanchard 1997 and Kolodko 2000a.



the Great Depression of 1929-32, World War II in 1939-45, or the energy crisis of 1973-77. To be more precise, the dominant factor is that of institutional continuity, accompanied by an incessant evolution of the mode and details of the institutions' operation, whereas radical changes and revolutionary transformations rarely come to the fore, which is the case with the postsocialist transformation.

However, in the latter instance, continuity remains a factor of great importance, both in those countries where the systemic changes were launched in a more radical manner, as in Romania, and in those where appropriate circumstances for the emergence of a new system and the first harbingers of that system existed already in the context of the old one, as in Poland. But now the question of continuity should be addressed from a slightly different angle, among other things, because of the increased scope (the world at large) and depth (all the spheres of economic activity) of the present phase of globalization. At the moment, **we are not only unable to predict when the transformation will finish, but even uncertain as to when it actually began.** Recurring doubts of this kind will have a bearing on the very definition of "transformation".

Interestingly enough, the annual assessment of the world economy in the year 2000 published by the International Monetary Fund treats China (as well as Vietnam and the remaining states of Indochina) as transition economies in the same sense this term is applied to Central and Eastern Europe and the former Soviet Union. What is even more interesting, such a methodological approach leads the IMF to the rather striking conclusion that the systemic transformation began in China already in 1978, and in Vietnam and Laos – in 1986 (IMF 2000b). Such an interpretation would perhaps have provoked less criticism, had the IMF consistently admitted that the transformation in Russia had been initiated already in Soviet times (in 1986, when the unfinished *perestroika* effort was launched) and in Poland in 1982 (with the declaration of martial law and the attendant package of economic reforms). And what about Hungary? In the light of the above, should we not shift the beginning of the transformation back to 1968? And in former Yugoslavia, perhaps even to the 1950s?

This is for many reasons a truly interesting problem and it is best approached using the example of China. Bearing in mind the vastness of that country and the fact that it has nearly doubled its output thanks to rapid economic growth at a time when Central and Eastern Europe and the former Soviet Union were hit by the Great Transitional Depression, which, on the average, slashed some 30% off their 1989 GDP level, the importance of China is steadily increasing. The transformation going on in that country will have far-reaching implications for transformation and globalization in their entirety.

China is undoubtedly more advanced in its progress towards market economy than many a post-Soviet republic. Would anyone venture to call, say, Turkmenistan a transition economy, bearing in mind that liberalization and market-institution building are less advanced there in the year 2000 than they were in Poland in 1989, were it not for the regional dimension of the entire transformation process and its global consequences? Certainly not. Both Turkmenistan and some other countries, such as Azerbaijan or Kazakhstan, would be described at best as reformed socialist (communist) economies. **In view of its geopolitical momentum, one can be reluctant about the transformation, but there is no escape from it. It exerts "gravitational pull" and everything that revolves around it must now revolve in the same direction.** China is no exception. Surely, it was not the intention of the Chinese reformers to abolish the socialist system and introduce capitalist economy (many of them still disclaim such intentions), and yet the actions they launched and, first and foremost, the inexorable logic of the transformation in the age of globalization lead to this very outcome.

In other words, the continuity factor has never ceased to operate – just the opposite. Its persistent influence results in a situation when the system enters at some point a qualitatively new phase which does not signify a continuation of the reform any longer, but marks the

beginning of a more advanced transformational process. A shadow line has been crossed which we were unable to notice before, whereas now it turns out to be a thing of the past. “Now” means here a situation when the system is believed to be irrevocably headed towards market economy, as a result of a process which has long been under way. The Chinese reform did not start off in this direction, but this is the point it is bound to reach eventually – perhaps even sooner than some economies whose progress towards the market is seemingly faster.

One more interesting dimension should be taken note of in the context of China. The transformation pertains not only to the economy, but also to the political scene, as it involves the transition not only to an open market, but also to a parliamentary democracy and civic society. This leads to the theoretical and practical question of the compatibility between marketization and democratization. Some commentators may claim, which is once again a matter of definition, that the postsocialist transformation implicitly assumes the implementation of democracy as part of the process. This view should be endorsed. If it is indeed accepted, then the Chinese case is not yet a developed form of transformation, but only an advanced market reform being implemented within the socialist economy. Incidentally, this reform has gone further by now than the reforms in Yugoslavia, Poland and Hungary had towards the end of the 1980s.

But it is also true that **in the long run a market economy cannot function efficiently in the globalizing economy and enhance its international competitiveness in a non-conflicting fashion without the institutions of a democratic state and civic society.** This is the right lesson to learn from the past experience of such countries as Chile, Indonesia, South Korea or Taiwan, notwithstanding any claim to the contrary. Under different conditions than in postsocialist countries, it was the maturation of the market institutions in a liberalized environment, opening up to extensive contacts with the outside world as the restrictions were lifted, that enforced democratic change. The latter may occasionally hinder economic reform, but in the long run it facilitates this process, for **democracy, apart from being a value in itself, is indispensable as a civilized means to rectify the excesses of free market and its mechanisms.** Time will come for everything, including democracy in China. Once established, it will lend support to the institutions of the market economy, which may (or may not) reinforce economic growth.

To state it briefly, China is only now entering the transformation stage, because now is the moment when the emergence of market economy in that country at some future date is becoming inevitable and irreversible. If, on the other hand, someone prefers to assume, in the interest of simplifying the categorization of countries, that this process began nearly a quarter of a century ago, it is a matter of convention, and not science. Many propositions can be adopted by general consent, but only some of them can be proved.

Yet there is also the global aspect: China is becoming a full-fledged postsocialist transition economy thanks to the parallel globalization process (the same goes for Vietnam and, in a slightly different context, also some post-Soviet republics). The above-mentioned countries also desire to join in the worldwide economic exchange and benefit from the transfer of information, technology, capital and goods. Such participation must follow the rules of market economy. Substitutes, like special economic zones or a two-tiered exchange-rate system, will not do any longer today. **Nowadays it is impossible to participate meaningfully in the international division of labor on other than capitalist terms.** Because market economy is a capitalist economy. Even if some countries, referred to these days as “postsocialist”, took rather long to understand this truth (and in the case of some, like Belarus, it is not yet a complete understanding), they have no choice but to press ahead, which means the creation of an efficient, competitive capitalist market economy in their territories, too.

As there exist different market economies, so the transformation will bring about different results, too. Although no one is, a priori, bound to succeed or doomed to failure, some countries enjoy better chances than others. This is due to both purely objective factors, such as geopolitical situation (it would be hard to imagine that one could be better off than Poland or worse off than Moldova in this respect), but also, as has been mentioned before, the advancement level of the institution reform under planned economy, prior to the transformation stage. Looking back, this too seems an objective factor in the form of a historical inheritance, but there was a time to prepare the ground for a future transformation by means of wise reforms, implemented with varying degrees of success. In Poland, the reforms were fairly successful, less so in Romania; Hungary did exceptionally well, Albania failed miserably; the one-time Soviet reforms were insignificant, the Chinese ones were of fundamental importance. The results are clearly noticeable today.

However, **the success is determined, above all, by the quality of the policy and especially the ability to coordinate systemic change with development strategy. These are two distinct domains of economic activity which call for appropriate theoretical underpinning that would maintain this distinction.** For whatever the system (or whatever the stage its fundamental modification – that is, transformation – has reached), it is always possible to conduct a better or worse economic policy within its framework. Thus in Poland, the far superior policy of 1994-97 was replaced by a decidedly inferior one in 1998-2000, whereas in Russia this order was reversed: the exceptionally bad policy of 1993-98 was followed by a visible improvement in 1999-2000. The results are evident. In Poland, it was the change of policy for the worse (rather than factors connected with the system, which is supposed to be changing for the better as the transformation proceeds) that brought about a significant deceleration of growth rate, a deteriorating state of public finance, and disturbed external financial equilibrium, while such pathological phenomena associated with market economy as corruption or organized crime are on the rise. At the same time the scale of these maladies in Russia has been gradually reduced, the condition of the budget has been improving, while output growth recorded a significant acceleration.<sup>29</sup>

Globalization is thus a powerful catalyst of transformation. Modern technological revolution, political change and economic knowledge have triggered globalization, which in turn unfailingly encompassed this huge region of the world where until recently socialist planned economy reigned supreme. Otherwise, what kind of worldwide economy would that be, without a sixth part of the earth's land area, inhabited by a quarter of the world's population? What kind of world economy would that be without access to the natural resources and "market" of this region with its enormous demand potential? Yet to take advantage of a full-fledged market, such a market has to be attained through the transformation process. Therefore, the outside world adopted all measures possible to ensure that the transformation process in former centrally-planned socialist states should take an appropriate form and direction, not inconsistent with the strategic interests of foreign economies as investors and manufacturers.

All this has a bearing on the transformation process and poses **a risk that the former socialist economy will be replaced with a not-necessarily-modern social market economy. With an occasional exception or two, this scenario can be avoided by the states seeking membership in the European Union, if only their policies of structural reform and socio-economic development strategies take heed of the imperative to form domestic**

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<sup>29</sup> Whereas economic policy errors after 1997 stifled growth in Poland from an average of 6.4% in 1994-97, when the "Strategy for Poland" was being implemented, to 4.4% in 1998-2000, the trend in Russia was exactly the opposite: from an average 5.3% drop of GDP in 1994-98 to an average growth of about 5% in 1999-2000. In 2000, this difference in Russia's favor was even more pronounced (a GDP growth of 4.4% in Poland and 7% in Russia).

**capital and institutions stimulating indigenous enterprise. Most postsocialist countries, however, will evolve into dependent market economies dominated in the key sectors by foreign capital, linked with local interest groups and oligarchies.** Although the Chinese road to capitalism has been, thus far, the negation of such a tendency, the emergence of this kind of postsocialist capitalism subservient to the interest of richer countries is all too plain in many countries and in various sectors of their economies.

The progress of the transformation so far indicates many destructive alliances between foreign and domestic interest groups which aptly (from the point of view of their particularistic interests) capitalize on the changes attendant on the transformation, especially in connection with the privatization and liberalization of trade, as well as the deregulation of capital movements. The most spectacular illustration of this phenomenon was the financial crisis which wrecked the Albanian economy in 1997. In the wake of the civil unrest unleashed by this situation, foreign armed intervention became indispensable to bring back some semblance of order. But by the time this happened, an amount of savings equivalent to 60% of the nation's GDP (incidentally, the lowest in Europe) had been embezzled and for the most part transferred abroad.

This is but one instance, but examples can be multiplied, pertaining to any one of the transition economies, although the scale of such harmful phenomena differs, depending on the strength of the emerging market institutions, maturity of the democratic system, as well as the general quality of public life – in particular, the involvement of the media, which may be equally well equipped to help combat this kind of sharp practice, and to engage in it and manipulate the public opinion more or less at will.

Even the assistance of highly developed capitalist countries sometimes turns out to be an illusion, because in reality it does not benefit the postsocialist economies as such, but only parts of their political elites. Janine R. Wedel presents the mechanisms behind such practices, at work in many countries (including Poland in the early 1990s, but mainly Russia) and rightly observes that, in the globalization process, the nationality of the agents is no longer important, as the world's elites are becoming ever more interconnected, while links with their nation states are gradually dissolved. These groups increasingly identify themselves as members of an exclusive club, rather than, say, Americans or Russians.<sup>30</sup>

This is, regrettably, true, and although one should avoid going to extremes and overgeneralizing, the threat must not be underestimated, either. Such phenomena are neither the norm, nor isolated pathological cases – these are fairly widespread patterns of behavior and modes of operation which have a qualitatively significant, negative impact on the entire transformation process. They weaken the economic viability and erode the social support for the reform, while strengthening anti-globalization sentiments in the process. And although distortions of this kind would not be possible in the emerging market economies without globalization, this is not to say that the latter is to blame: the real culprit is the dishonesty of some part of the political and economic elites. It has various underlying causes, but it is mainly a consequence of the institutional weakness of the postsocialist state and the lack of determination on the part of its leaders to eradicate such attitudes.

The simultaneous progress of globalization and transformation processes means that capitalist economic relations are gradually taking hold all over the world, including its postsocialist part. And since this part of the world has, quite naturally, much weaker institutions and very meager capital resources at the current stage, it is particularly liable to become dependent on the institutionally mature and capital-rich dominant sector of the world

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<sup>30</sup> Quoted after *Johnson's Russia List*, No. 4661, 30 November 2000. Janine R. Wedel, Anthropology Professor at the University of Pittsburgh, is a keen observer and unrelenting critic of the distortions accompanying the transformation. She was granted Grawemeyer Award for Ideas Improving World Order for her book analyzing foreign (that is, predominantly American) aid for postsocialist countries. See Wedel 1998.

economy. Thus the “oneness” of the world economy is becoming increasingly evident as a single, integrated world marketplace is formed. This does not contradict the fact that there is one world only but many different situations occur therein. As in a posh boutique: someone is the owner and someone is the supplier of high-quality merchandise; someone is a rich client and someone just a window-shopper; additionally, someone is needed just to clean the floor.

The situations in which postsocialist economies more and more often find themselves are not always necessarily a good omen for the future – certainly not for everyone. Those who believed (or do they still do?) that the systemic transformation would provide a direct and fast route from the socialist “second world” to the “first world” of developed capitalist economies would be well advised to accept the more probable scenario assuming that the route leads to the “third world”. Meanwhile, the latter has been renamed – due to globalization – “emerging markets”, but that hardly matters indeed.

This means that, on the one hand, **globalization restricts the freedom of the transition economies with respect to both economic-policy choices and the ways of market-economy institution building**. And so their financial policy must take into account global requirements communicated to them through the International Monetary Fund, with all the encumbrance of the orthodox neo-liberal monetarist doctrine (whose utility is often limited in the case of transition economies); additionally, the prospective members of the European Union must comply with its institutional standards (*acquis communautaire*). This situation is increasingly perceived and accepted as the “natural state of economic affairs”. If not, any country which refuses to open up to free international trade and foreign investment is heading for a failure.

On the other hand, **globalization does not in any way impose the uniformity of systemic arrangements and policies**. At least not at the present stage. Governments still have much room for maneuver and the actual scope of latitude they enjoy in taking purely sovereign decisions concerning many issues vital for the economy and society may even in some cases surpass their capacity for effective action. Accordingly, they are not (nor will they be for generations to come) exonerated in any respect from the responsibility for the national economy.

**Globalization presents more opportunities than threats for the development of postsocialist economy**. However, at least two conditions must be met in order to take advantage of this situation. First, countries cannot afford to lose their economic sovereignty in an early phase of the transformation and thus to restrict greatly their ability to influence the reproduction process on their own. Second, what is needed is an appropriate program of institutional reform and an associated socio-economic development strategy, capable of turning the round-the-clock progress of globalization to the advantage of the nation and the (still national) economy.<sup>31</sup> In many countries these conditions are not met, either because of the excessive dependency on external financing, or in the absence of a suitable conception of economic policy.

Undeniably, any postsocialist transition economy in the process of opening up immediately becomes entangled in external financial ties. Faced with immense capital needs combined with the Great Transitional Depression, all such countries quickly run into debt, sometimes beyond their current and future capacity to repay. If this is the case, they soon fall into the debt trap. Such was the fate of many postsocialist countries large and small: from

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<sup>31</sup> This “round-the-clock” quality is of more than symbolic importance. Due to globalization, business activities go on non-stop. Without a moment’s respite, processes are unfolding outside every national economy which affect this very economy. By contrast, the pursuit of a policy – in particular, economic policy – takes a nightly break. Previously, it did not matter, since “everyone” was asleep. But now someone is always awake and doing business – promoting his own interests, not necessarily ours.

Albania to Ukraine to Russia.<sup>32</sup> In contrast, China – the biggest of all – has followed its own path without giving up control of its own economy just for the sake of liberalization and reforms, and thus avoided this danger.

Given the present-day institutional order prevailing in the world, a country which has run into excessive debt has no choice but to seek the support of the International Monetary Fund, or else it will be cut off from the private capital market. No formal barriers of this kind exist, but in practice, there is nothing it can do without reaching an agreement with the IMF. Therefore, access to the necessary foreign financing ultimately depends on accepting the terms of the Fund's stabilization packages, which typically prescribe a rather one-sided structural reform policy, based on the orthodoxy of the so-called Washington Consensus (Kolodko 1998). If such a package involves the second of the above-mentioned components, that is, when it enforces a sensible economic policy, things take a turn for the better. Unfortunately, this is not always the case.

In all postsocialist countries – and indeed, anywhere in the world – the importance of the external political, institutional and financial factors is overestimated. This is particularly true about the role of the International Monetary Fund and the World Bank (incidentally, these institutions have vastly different functions) and their impact on the transformation. **Some countries are more and some less successful not because they do or do not take heed of the suggestions proceeding from the IMF and various other places in the globalized economy, but because they have a better or worse economic policy of their own.**<sup>33</sup>

The future will be determined by the quality of the policy, although, as we are all well aware, the inheritance of the past and geopolitical situation also have a significant impact. The outside world may offer assistance, too, but it may just as well do harm. Which is the case, depends mainly on the national economic policy. Certainly, a good policy can only be based on a good economic theory. It is likewise certain that a good theory alone (which does not always prevail anyway) is not enough. Therefore, the success of the economic transformation is crucially linked both to the political transformation and to the quality of human capital and cultural change.

The worldwide marketplace that is taking shape thanks to globalization has all the advantages of all markets – allocative efficiency, adaptability to the changing conditions of reproduction, responsiveness to economic initiatives etc. But it also has all the drawbacks of all markets – unemployment, negative external effects, excessive income differentiation,

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<sup>32</sup> It is already clear that Russia, despite several rounds of restructuring, will once again lose the ability to service its foreign debt by 2003 at the latest, when payments in an aggregate amount in excess of 17 billion dollars become due. Under the circumstances, renewed proposals are being made to convert part of the foreign debt into state property awaiting denationalization. Even if this does not take the form of a direct debt-to-equity swaps, it will, economically speaking, really boil down to it, since public-debt repayment is being increasingly financed with privatization revenues. The situation of Poland is similar. Although the initial foreign debt, which stood at a little more than 40 billion dollars in the early 1990s, has been reduced by half, Poland's foreign debt by the end of the decade had increased to 70 billion dollars (the aggregate debt of the government, central bank and enterprises). In the years 1998-2000 alone, it abruptly increased by more than 21 billion dollars, thus limiting the room for maneuver for the government and debtor enterprises alike. Worse still, it did not do much to improve the competitiveness of the economy, as is demonstrated by the concurrent two-and-half-fold increase of the current-account deficit: from 3.0% of the GDP in 1997 to 7.5% in 1999.

<sup>33</sup> I would also be able to elaborate on this claim and substantiate it on the basis of my own experience, both in research work, carried out in 1991-92 and then again in 1999-2000 at the International Monetary Fund, and, especially, in the Polish government, where I was responsible for economic policy in 1994-97. These were the best years in the history of the Polish transformation, which was to some extent also due to the fact that, as Deputy Prime Minister and Minister of Finance, I followed IMF advice only when it was sound; when it was not – which, after all, happened more than once – I stayed the course, sticking to our internal line and resisting the pressures and suggestions from the outside.

marginalization and exclusion of part of the population from the production and consumption processes, lack of stability leading to production and financial crises etc. The transformation has both types of consequences, while globalization brings in an additional aspect to both the benefits/advantages and threats/risks entailed by market economy. **What goes on within a given postsocialist national economy increasingly depends on what goes on outside – in the world economy. However, so much is still going on within every national economy that, indeed, the internal economic policy continues to exert a dominant influence on further system evolution and socio-economic development.**

Technological progress and new technologies offer a competitive advantage to the inventors only for some time. This truth is even more relevant today, in the age of information technology and the Internet, than it was in connection with railways and the telephone. Thus postsocialist countries stand a better chance of accelerated growth, to be achieved through the improvement of their technological base by adapting foreign inventions and technologies to their purposes.

Globalization should, in turn, be utilized as an excellent opportunity to absorb foreign direct investment, which enhances the country's competitiveness and facilitates profitable access to other sectors of the world market. It is thus a matter of wise national strategies to create ever better-paid jobs in sufficient number to offset the natural loss of jobs that occurs along the way in connection with the transfer of new production technologies and the elimination of old ones.

If all these advantages are combined with the evidently improved allocative efficiency that stems from maturing market institutions and the consolidation of financial stabilization into stability, the road to economic success will open up. Some postsocialist countries will then have a chance to catch up with today's richest countries in the world in a matter of two generations (Kolodko 2000b). A historic chance is thus being offered to great numbers of people in two immense continents thanks to three unique factors which make things happen the way they happen, precisely at this time:

- **fourth industrial revolution;**
- **present phase of permanent globalization;**
- **first postsocialist revolution.**

Some will make the most of this chance; others will miss it. But the main point is that we already know what it is going to depend on.

## **6. The beginning of history**

And so it is not the end but the beginning of history we are witnessing. Now at long last nearly everyone will be involved in making history. How exactly – we shall see. After all, there is plenty of time with an entire new millennium ahead.

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