GLOBALIZATION, CAPITAL MARKET AND HUMAN RIGHTS

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Globalization is a term often used loosely. It is ubiquitous in the titles of scholarly articles but few authors feel the need to define it. Its ubiquity owes much to its broad reach. Few fields remain untouched by the phenomena of globalization. However, one suspects that its meaning is refracted through the lens of each discipline so that it means slightly different things in different fields.1

The search for a dictionary definition of globalization tells one much about the phenomenon. A search of the issues of the leading dictionaries available in my university library turned up no reference to it. It is a new term. Appropriately enough, however, definitions abound in cyberspace. In Investorwords investing glossary, globalization is defined as "the increasing tendency toward an interconnected worldwide investment and business environment".2 In the Yahoo Finance Financial Glossary, the term is defined as "the tendency toward a worldwide investment environment, and the integration of national capital markets".3

These definitions address only the financial aspects of globalization, and while finance is the most globalized activity4 and the globalization of financial markets increased significantly in the 1990s,5 globalization itself is a much wider and more imprecise phenomena. It is a broad church that arises from6 the computer and communications revolutions, the growth in multinational enterprises, the tremendous increase in international institutional investment, the movement towards unregulated international markets for goods and capital (and highly regulated international markets for ideas7), and

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1 Commet of Dr. Haig Patapan, at the colloquia at Griffith University, March 31, 2000.
3 Available at http://biz.yahoo.com/lg/ibfglos.html.
7 The U.S. policy approach, in broad terms, is to push for free and unregulated movement of goods and capital but to insist on very strong proprietary right over intellectual property which, of course, severely limits its movement. It is a nice contradiction that is too often overlooked; and, of course, a policy stance that serves U.S. interests admirably.
includes the degradation of environment, the deterioration in labor standards and the loss of local culture in many countries; and, after the abortive Seattle meetings of the WTO late last year, pretty well anything else that is bad about the world.

While these elements of globalization are in the main relatively recent, it is not a new phenomena (although, as it becoming apparent, it is a relatively slippery one). The Roman Empire was the most important force for globalization the world had seen and financial globalization was so strong in the late 19th and early 20th centuries that the scale of international capital flows relative to GDP is still to be repeated.

In essence, globalization arises from the information revolution, the international financial revolution, and the international victory of free market capitalism in the contest of ideologies and the associated reductions in national barriers to trade and capital. It is a process with many facets. I wish to consider the impact of globalization on capital markets and the impact of globalized capital markets on human rights in developing countries.

The Globalization of Capital Markets

The globalization of capital markets includes the following phenomena and trends:

1. Massive capital flows are a fact of life and foreign investors in particular are opportunists. Foreign investors quickly move money into an economy in large quantities and, as we saw in Mexico in late 1994, Asia in 1997 and Russia in 1998, will seek to remove it even more quickly when storm clouds gather.

2. The nature and management of investors changed radically in the 1990s. The proportion of capital controlled by the large institutional investors (mutual funds, pension funds, and insurance companies) increased dramatically. Hedge funds brought aggressive new investment techniques to bear. More significantly, but with less publicity, virtually all major commercial and investment banks and securities firms established departments that functions as hedge funds and make extensive use of leverage and derivatives and the capacity to move in to and out

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9 The net capital outflow from the UK before 1914 peaked at some 9% of GNP and the proportion was almost as high for France, Germany and Holland, the other major creditor countries. These proportions have not been achieved since. Likewise, current account deficits of the principal capital importing countries, Argentina, Australia and Canada, were over 10% for long periods. These levels have only been achieved by developing countries for short periods, which typically have been followed by very difficult adjustments: B. Eichengreen & M. Mussa, Capital Account Liberalization: Theoretical and Practical Aspects, IMF Occasional Paper No. 172, 1998, at 31. While net capital flows relative to GDP were, if anything, higher pre-1914 than today, gross flows are much higher today. Furthermore, investment pre-1914 was overwhelmingly in the bonds of governments, railways, mining companies and public utilities. Some 85% of overseas investment was in the bonds of governments (that can raise taxes) or industries with substantial tangible and transparent assets. This was a rational choice of investment target given the poor information available: Eichengreen & Mussa, id at 32-34.

10 The following factors owe much to Henry Kaufman, "Protecting against the next financial crisis: the need to reform global financial oversight, the IMF, and monetary policy goals", 34 Business Economies, July 1, 1999, pp. 56.
of markets swiftly.12 Indeed, the entire money management sector has become far more performance-driven, less risk averse and more inclined to use leverage heavily.13

3. Access to up to the minute information facilitates investment decisions at great distances and foreign investors receive relatively homogenized information. Before the communications revolution, long-term investment was often the only sensible approach to foreign investment. Today, an investment portfolio in Brazil can be managed as aggressively and intensively as if it is in one’s own, yet the sources of information upon which the investment decisions will be based are far less diverse than if it was in one’s country, with predictable consequences for investor behavior.

4. Modern financial derivatives provide tremendous opportunities for hedging risks, but are perhaps more often used to facilitate speculations and as integral elements of volatility inducing activities. Certainly “an increased use of derivatives leads to higher cross-border capital flows…, thus leading to a rise in the asymmetry of information and therefore in financial volatility.”14

5. In the contemporary capital markets with efficient depository and settlement

systems, liquidity can be temptingly easy to believe in. ‘if it trades like a global bond and settles like a global bond, it must have the other characteristics of a global bond.’ Capital markets that are deep and efficient in good times can rapidly become thin, volatile and illiquid in bad times. This is especially true of secondary markets in debt and of access to new money through debt issues.15

6. Due to the above factors, capital markets in the debt and equity of developed and developing nations are integrated and interdependent today to an unprecedented degree.16

Each of these aspects of globalization tends to increase the volume of portfolio capital flows to emerging market nations and the volatility of such flows. Indeed, there is considerable evidence that globalization of financial markets increases the volatility of such markets.17

The globalization of capital markets gives countries access to new sources of capital and capital drives economic growth.18 This is its great attraction. However, as the international debt crisis that erupted in 1982 and the more recent currency and financial crises in Mexico, Asia and Russia have demonstrated, generous access to foreign capital is often far from a good thing for developing countries. A slick intellectual trick is

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13 As Makin wrote in 1994: “Strategies once deemed to be on the wilder, forbidden shores of the business are being eagerly embraced by maintain institutional investors”. C. Makin, “Doesn’t anybody remember risk?” Institutional Investor, April 1994, p.41.


15 Buckley, op. cit, n.12.

16 Ayuso & Bianco, op cit n.5. For instance, Russia’s economic troubles in August 1998 sent yields on the U.S. long bond to unprecedented lows and affected even U.S. municipal bonds: Buckley, id.

17 Ayuso & Bianco, op cit, n.5; Buckley, op cit, n.12; and Bustelo, Garcia & Olivie, op cit, n.14 at 68.

often perpetrated here. Free trade in goods and services is generally accepted among economists as welfare enhancing. It tends at times to cause severe change and economic dislocation in countries, but overall the result of free trade is a wealthier world. The trick is to assert that what holds for goods holds also for money. Isn’t money just another good? Legally it is often treated as such. Experience tells us otherwise. The difference is that capital has to be repaid.

Capital is only welfare enhancing if put to productive uses that generate returns in excess of the cost of the capital. The failure by Latin America to do this with the massive loans of the 1970s led to the debt crisis of the 1980s. Likewise, the incapacity of the East Asian financial systems to channel the increased capital flows to the early and mid-1990s into productive uses contributed significantly to the Asian crisis of 1997. The Asian economies were performing strongly before foreign capital flows to the region increased due to local capital market liberalization, surplus liquidity in the U.S., and the dissuasive effect the Mexican peso crisis in late 1994 had on further capital flows to Latin America. It is therefore not surprising that the increased capital flows of the 1990s ended up fueling speculative bubbles in local stock and real estate markets.

The clearest lesson of the recent economic crises is that unfettered capital mobility is not necessarily welfare enhancing and not an unmitigated good.

Impact on human Rights in Developing Countries

The globalization of capital markets leads to greater international portfolio capital flows and “increases the vulnerability of emerging markets to crises”. In good times, these flows support growth in developing countries. In bad times they cause untold and appalling human suffering. The key lies in whom portfolio capital flows serve in good times and whom they harm in bad times.

The huge loans to Latin America of the 1970s brought “massive returns to the rich”. However, when these loans had to be repaid in the 1980s they were repaid by increasing taxes, reducing price supports on essential items and cutting spending on public health care, public education and public infrastructure. The rich benefited from the loans, the common people and the poor repaid them.


22 Bastelio, Garcia and Olivier, op.cit n.14 at 83.
Like wise in Asia the boom in portfolio capital flows and lending to the region in the early to mid-1990s principally benefited the rich. The dislocation and impoverishment brought on by the crisis in 1997 has, however, fallen far more heavily on the shoulders of the common people and the poor.\textsuperscript{25} With the exception of Indonesia, Asia has recovered far more quickly from its crisis than Latin America and sub-Saharan Africa were able to recover from 1982 crisis. Nonetheless, the profound inequality between who benefits from international capital, and who pays for it, has been maintained.

As Nora Lustig has written, “Macroeconomic crises, with the exception of wars, are the single most important cause of large increases in ... poverty”\textsuperscript{26}, or in Charles Calomiris’ words, “When the crisis has passed, the big winners are the wealthy, politically influential risk takers, and the biggest losers are the taxpayers in countries like Mexico or Indonesia”.\textsuperscript{27}

This transference of responsibility onto the poor is depressingly consistent. After the debt crisis broke in 1982, the international banks required that all loans, corporate and sovereign, be brought under sovereign guarantee as a way of facilitating rescheduling negotiations. This is did. It also improved the security of the banks, dramatically. The largest banks benefited the most from this stratagem, as they held the highest proportion of loans to the less creditworthy private sector. Unsurprisingly, these were the banks in charge of rescheduling negotiations.\textsuperscript{28}

In East Asia in 1997 the great majority of the debt was to the private sector. But this did not stop the taxpayer from eventually bearing it. The IMF-led bailouts, invariably described as bailout of Indonesia or Thailand or Korea, were in fact, long-term loans to those countries that had to be used to repay the short-term creditors. These loans thus became debts of the nations and the bailouts were of the creditors, not the debtor nations at all.\textsuperscript{29} (Incidentally such bailouts must stop. In the Asian context, the bailouts rewarded the short-term creditors who had helped precipitate the crisis and did nothing for the creditors who advanced the type of debt that needs to be encouraged: long-term debt. The bailouts were very damaging for the poor of Asia and virtually guaranteed the creditor behavior that in 1998 was to greatly exacerbate Russia’s crisis. But that is another story.)

The repayment process in times of crisis is generally directed and orchestrated by the International Monetary Fund. In Latin America and Africa in 1980s the IMF’s structural adjustment programs have been shown to have infringed numerous basic human rights.\textsuperscript{30} After initially advocating and requiring a fiscal austerity that deepened the Asian crisis, the IMF all but admitted its initial stance was wrong and agreed inflationary policies in many countries that have aided the region in its generally rapid recovery from the crisis. Nonetheless, there are children today in Indonesia, Korea and

\textsuperscript{25} On the World bank’s estimates, the Asian crisis has plunged many million into poverty: “Crisis in Asia Spawns Millions of ‘Newly Poor’”, The Wall Street Journal, April 6, 1999, B-5A.

\textsuperscript{26} Lustig, op.cit n.21.


\textsuperscript{30} Dohnal, op.cit, n.24.
Thailand who have not enough to eat or have to work, rather that attend school, because of the impoverishment and economic dislocation brought about by the Asian crisis, a crisis to which international capital flows contributed significantly.