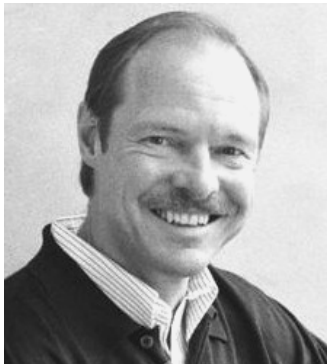


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# Perspectives



## **Globalization: How Wall Street's Opportunity became Wall Street's Headache**

The US economy is firing on all cylinders, but the stock market keeps trading water. Most analysts blame terrorism, the mess in Iraq, high oil prices and presidential election uncertainties, yet little is being said about another factor: the ongoing globalization process.

Why is globalization giving the stock market a headache? Let me explain. During the past 15 years, the volume of trade in goods and, more recently services, has exploded. It's important to recognize that the proliferation in trade and the opportunity it created for many of the less developed economies, was only partly the result of planning. To at least as large an extent, the changes we've witnessed were caused by technological evolution.

### **Calling Dell in Bangalore**

The other day, I had a problem with my laptop. When I dialed the toll-free tech support number provided by Dell Computer, a lady in Bangalore answered. Hundreds of thousands of people in India are now America's telephone operators, code programmers or airline reservation coordinators. Ten years ago, some of the more astute economists started writing about the exodus of manufacturing jobs, but no one I know of thought that service sector jobs would follow so fast and in such mind-boggling numbers.

But while the manufacturing and service outsourcing boom is expanding the new Chinese and Indian middle class at a rapid rate, other areas of the economy have not evolved. Government bureaucracies, especially, are clinging to models and practices which are incompatible with free market principles. In China, for instance, enormous sums of money have been lent to old-style, inefficient businesses and industries that are no longer capable of servicing their debt. In India, banking difficulties are less severe, but the state remains extremely interventionist. And in both nations, as well as many others in the developing world, corruption remains endemic.

In my opinion, overcoming these problems will characterize the second multi-year phase of globalization. Inefficient industries will need to be replaced by productive ones, bank regulations tightened; interventionism has to be curtailed and corruption eliminated. Doing so will take far longer than many analysts think: the old ways are deeply entrenched in culture and changing them can cause large-scale social upheaval. In China, for instance, the discontinuation of unproductive, state-run industries has thrown millions out of work. Many of the unemployed cannot easily be retrained or redeployed. And in India, the elevation of a few hundred thousand to a far higher standard of living is bitterly resented by the impoverished masses.

## **The Trouble with Democracy**

India is a democracy. As we saw last month, social tensions have manifested themselves in a change in political regime. Former Prime Minister Vajpayee, who brought large-scale opportunity to his country, got dumped in favor of Sonia Gandhi's Congress Party, which told India's poor that they'd been cheated. China is not a democracy and, at the moment, that may be a good thing. If it were, the current leadership would be sacked and the clock would be turned back. The pan-Asian economy, and in turn the world economy, would go into deep-freeze. For the moment, China's leadership is doing exactly the right thing: trying to adopt capitalistic principles, but at a sustainable pace.

The way I see it, then, is that Phase I of the globalization process (let's call it "Creation of Opportunity") will now be followed by the far more difficult Phase II (we can label it "Letting Go of the Old Ways"). Those who succeed will arrive at Phase III, which will place them in the league of nations that has embraced basic economic freedoms and can generate stable economic growth. Unfortunately, relatively few will make it, even though the incentives are immense.

Just as most emerging nations never thought of capitalizing on the advantages of globalization (I'm talking about Africa, the Middle East and about half of the Latin American continent), a considerable number of countries which exploited the promise of globalization will never make it to the next phase. In Latin America, I am particularly concerned with Brazil and Argentina, where no meaningful reforms have been adopted; in Asia, places like Vietnam come to mind.

## **China's the One**

By far the largest question mark, however, remains China. Even though the leadership appears committed to doing the right thing and has so far done an extraordinary job under very difficult circumstances, the task of orderly transition is monumental and no one can say what hiccups will occur along the way.

To the growingly mature, mainstream economies, Chinese progress and stability is paramount. A meaningful economic slowdown in China would be most deeply felt in Japan and South East Asia, but the repercussions for Australia, Europe and North America would be significant as well. The stock market has taken note of that. □

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