Chapter 1

Integration, Development, and Global Economic Crisis

In a world of ever greater integration, in which the new information and communication technologies facilitate and reinforce the functioning of, and the interaction between, firms and organizations, production systems and markets gradually acquire a global dimension. Globalization is a multidimensional process characterized by the increase of international economic and financial flows, as well as by cultural, political, and institutional exchange.

In contrast to what is frequently claimed, deeper economic integration has expanded the diversity of paths of growth that economies can follow. Countries, regions, and cities differ from each other in the quantity and type of economic, human, and cultural resources and strategic assets they have at their disposal. However, the process of economic growth and structural change as well as the level of well-being depend, above all, on the forces and mechanisms through which the process of sustainable development is fostered.

The current global crisis has brought into question the development processes that liberalization and economic integration have stimulated since the mid-1980s. The global recession has brought out the fact that productivity growth and economic progress do not affect all countries to the same extent. Inequalities in the standard of living have progressively increased, as has the income gap between rich and poor countries. Even the differences among less developed countries have increased in such a way that for emerging countries the income level is situated ever closer to that of developed countries and the level

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of poverty is gradually declining (mainly in the case of China), whereas less developed countries see absolute poverty increase and suffer from international exclusion. The ongoing global crisis is raising poverty levels and widening income differences among countries and regions.

Globalization and Economic Integration

Since the mid-1980s, the process of integration has accelerated progressively as a consequence of the end of the Cold War, the gradual liberalization affecting international economic exchange, and the strengthening of economic regions. All of this has led to a new paradigm: globalization.

Globalization is a process whose emergence some authors, such as Ferrer (1996), place at the beginning of the modern age, but that was truly consolidated during the period 1870–1914 (O'Rourke and Williamson, 1999). The present stage began around the mid-1980s, with a progressive increase of international trade, growth in capital flows, a new spatial organization of multinational corporations, and strong progress in information and communication technologies. Therefore, globalization means a remarkable increase in the integration of economic and financial markets.

International trade and economic integration

Beginning in the mid-1980s, an important expansion of global exports took place, with a fivefold increase of international trade during the last 30 years of the 20th century, due in great part to the reduction of trade and investment barriers. The newly industrializing Asian countries (Korea, Hong Kong, Singapore, and Taiwan) significantly strengthened their positions in global trade, to the extent that they have doubled their share of manufactured exports on a global scale. Latin America also enjoyed a high growth rate between 1990 and 2002, at a yearly rate of 9.1%, surpassed only by China and Southeast Asian countries. The opening of markets produced a rise in the exports of manufactured goods from developing countries, which in

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1998 made up 80% of their total exports (compared to 25% in 1980); in China and also in low-income countries such as Bangladesh and Sri Lanka, manufactured products even exceeded the share of 80% of total exports.

At the same time, as a result of digging more deeply into the liberalization and economic integration processes, the dependence on international markets increased, particularly for the developing countries (UNCTAD, 2008). Between 1995 and 2007, the exports-to-GDP ratio practically doubled from 26.1% to 51.8%. Particularly striking was the increase in integration in Africa (the ratio rose from 21.9% to 49.7%) and in Asia (from 33.9% to 60.8%), and above all the levels reached in Central Africa (132.8% in 2007), Southeast Asia (100.3%), and East Asia (58.9%). In the developed countries, the dependence on international markets has not increased significantly in recent years (the ratio rose from 21.2% in 1995 to 28.4% in 2007), except in the case of Canada (where it rose from 32.5% to 48.0%) and the European Union (from 30% to 55%). Japan and the U.S. have little exposure to the international markets, since exports represented only 13.5% and 10%, respectively, of the GDP in 2007.

Development strategy based on growth led by international trade has given good results, with increased economic and social progress in many developing countries. Their more important markets continue to be the more developed countries, as shown by the fact that in 2007 almost 50% of their exports went to the U.S. (21%), the European Union (18%), and Japan (8%). Yet, the most significant fact may be the increase in South–South merchandise trade that grew threefold between 1995 and 2007 and that has contributed to the diversification of production, the attracting of investment flows, and the creation of new markets.

The worldwide economic boom from 2002 to mid-2008 contributed to the expansion of international markets and to an improvement in the living standards of the population. Increase in international demand also produced a boom in the price of commodities exported by developing countries, which gave way to gains in the terms of trade, which in turn improved the economic situation

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of the exporting countries of agricultural, mineral, and petroleum products.

Internationalization of production

The short-term and long-term capital flows have intensified, enabled by the international banking system and new financial intermediaries such as pension funds, investment banks and funds, and insurance companies (Eichengreen, 2000). Nevertheless, financial expansion has been subject to constant fluctuations in recent decades, which produced great turbulence in the economies of developing countries, as analysts and international organizations have pointed out. External financing has oscillated from one period to the next, reaching its peak during the periods 1977–1982 (2.3% of the GDP of developing countries) and 1993–1997 (2.8%), and its minimum in 1983–1990 (0.5%) and 1998–2000 (0.7%).

One of the most striking facts is the growth of foreign direct investments. Over 79,000 multinational corporations (MNCs) operate in the global economy through 790,000 foreign affiliates, and they have developed new organizational and territorial strategies that have stimulated mergers and acquisitions of companies. In 2007, their foreign direct investment (FDI) stock was US$15.211 trillion (from US$789 billion in 1982), total sales amounted to US$31.197 trillion (from US$2.741 trillion in 1982), and the number of employees in the foreign affiliates was 81.615 million (from 21.524 million in 1982). Cross-border mergers and acquisitions contributed to the increase in FDI; in 2007 this kind of transaction amounted to US$1.637 trillion, while in 1990 the value at current prices was US$200 billion.

The flow of foreign direct investments has risen from an annual average of US$73 billion during 1980–1984 to US$735 billion during 1995–2000 and to US$1.833 trillion in 2007, the all-time record. Even though the most important flows are registered between developed countries, in the developing countries they have grown considerably, increasing more than 15-fold between 1980–1984 and 2004–2007 (UNCTAD, 2008). The principal recipients of direct

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investments among the developing countries are China and the 12 main emerging countries, amongst which Argentina, Brazil, Chile, Malaysia, Mexico, the Russian Federation, and Thailand stand out.

As a result of the economic boom and good firm results, direct investment grew in all groups of countries between 2003 and 2007. In developed countries, the FDI inflows reached US$1.248 trillion (68% of the total) in 2007; the U.S. received the most investments, while in the EU it reached two thirds of the total of direct investments. Developing countries increased their participation in investments received (from 25.6% in 1995–2000 to 31% in 2004–2007). Among the most important receptor countries, China, Hong Kong, and the Russian Federation stand out.

Another prominent feature is the growing importance of multinational corporations (MNCs) in developing countries, which represent 15% of the companies in the Fortune Global 500 list (Casanova, 2009; Athukorala, 2007). Since the fall of the Berlin Wall in 1989, Southern MNCs have experienced remarkable growth as developing countries have become more important as sources of FDI, which in 2007 reached a record US$253 billion. The expansion of direct investments from developing countries is reinforced by the growing importance of the sovereign wealth funds, which in recent years have made important investments in cross-border mergers and acquisitions from the developed countries.

According to the UNCTAD World Investment Report 2008 (UNCTAD, 2008), the presence of transnational firms has increased in recent decades. The manufacturing and petroleum firms (such as General Electric, Toyota, Ford, Shell, and British Petroleum) maintain the highest positions in the UNCTAD ranking, although the presence of firms devoted to the service sector is growing. Most notable is the growing presence of MNCs in emerging countries, which in 2006 increased their foreign assets by 21% with respect to the previous year. The category of "the top 25 non-financial MNCs from developing countries, ranked by foreign assets in 2006" is dominated by firms from East and Southeast Asia (six Chinese firms; four each from Hong Kong, in particular Hutchison Whampoa Ltd., and Korea; and two each from Singapore and Malaysia), but the

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presence of Latin American firms is also growing (three from Mexico and two from Brazil). The most important activities are devoted to electrical and electronic equipment goods, telecommunications, motor vehicles, petroleum, and the industrial chemical industry.

Integration: an incomplete process

Thus, globalization is a process of integration that is associated with greater exchange of goods and services, the internationalization of capital, and an increase in the international production of multinational companies. For many, however, the feature that most characterizes the current stage of the globalization process is the fact that the internationalization of markets, capital, and production is linked to the introduction of new technologies, especially information and communication technologies (ICT). This is in clear contrast to earlier periods, which focused more on the search for raw materials and new markets for products.

Which factors are responsible for the acceleration of the process of economic integration since 1980? The OECD (1996) argues that the most important factors are the following: the new trade and investment policies, which have liberalized the markets for goods, factors, and services; the new spatial strategies of multinational corporations, which make use of the opportunities for location that economic and social integration provide them with; and the introduction of innovations in information, transport, and communication technologies, which facilitate the integration of markets and multinational production as well as reduce the cost of production and exchange.

The current period of globalization has established a new international order and a new international division of labor. The leadership position in the global economy is held by the OECD countries and some newly industrializing countries in Asia (South Korea, Singapore, and Taiwan), which have liberalized their markets and privatized a good share of their public companies, which have opened their economies to international capital, and whose production systems are highly integrated internationally. To them should be added a group of late developed and emerging countries that have

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increasingly globalized and integrated in the international markets. These include around 24 countries, among which are Argentina, Brazil, Chile, China, Hungary, India, Malaysia, Mexico, the Philippines, the Russian Federation, South Africa, and Thailand. The remaining countries, especially the extremely poor African countries and some that were part of the former Soviet Union, remain excluded from globalization unless they show themselves to be capable of opening their economies to international markets.

Is globalization really such an important and relevant phenomenon for the national economies? The available information shows that its dimension has probably been exaggerated, particularly when compared to previous periods in the process of globalization. As suggested by Ferrer (1996), globalization is a phenomenon that is not as extended as it appears to be. Although economic integration has increased during the last decade, there remain important areas of the national economies that are only indirectly affected by this integration. According to the United Nations, 75% of the global production has been sold in local markets, 90% of investments have been financed by domestic savings, and 9 out of 10 workers worked for national markets during the 1990s.

The international trade and foreign investments of developing countries have increased spectacularly, but the flows of international money and finances as well as labor have not yet reached the levels attained during the period 1880–1914 of the globalization process. According to Maddison (2001), in 1998 the stock of international capital represented 22% of the GDP of developing countries, a value quite inferior to the 34% reached in 1914. Between 1870 and 1910, around 10% of the global population migrated to other countries; while during the middle of the current decade, only 2% (120 million) of the global population lived in foreign countries. Therefore, once the ongoing global crisis is over, it is likely that the globalization process will increase but under a different pattern.

Lastly, the diffusion of information and communication technologies has had a significant economic and social impact, but it seems relatively less important than the innovations of the period 1870–1914. It has facilitated the production and exchange of

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information between firms, financial institutions, and clients and suppliers; but there is less potential for increasing its effects on global productivity and for achieving the creation of new consumer products and investment goods, as did the electric engine from 1870 onward. Furthermore, even though the diffusion of information and communication technologies has favored changes in the firms' organization and management, mainly in the systematization of administrative and routine tasks, its contribution to the transformation of hierarchical organization models of large enterprises and to improvements in the quality of human resources has been rather limited until now. In the area of transport and communication, the period 1870–1914 was substantially more innovative than the current one, with the substitution of wind-powered navigation by steam-powered navigation, the development of automobile and aviation industries, and the expansion of the railroad. Therefore, there is plenty of room for new developments in the near future.

The Global Economic and Financial Crisis

The ongoing crisis is a global financial crisis that has spilled over into the real economy. It started in the United States during the first quarter of 2007, with the lack of liquidity and the decline in solvency in the financial markets when the banking system incurred important risks because of the default on an important part of the subprime mortgages. After the collapse of the investment bank Lehman Brothers and the nationalization of the insurance company AIG in September 2008, the crisis spread to international markets through the stock exchange, the international banking system, and the monetary standard (Bordo, 2008).

The financial crisis has contaminated the functioning of the economy, generating a decline in GDP during the last quarter of 2008, and this contraction continued throughout 2009 (IMF, 2010). According to the IMF *World Economic Outlook* of October 2009, the "global economy is expanding again.... It will still take some time however until the outlook for employment improves significantly" (IMF, 2009a). Global activity contracted by 0.6% in 2009. GDP, in real

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terms, declined by 2.4% in the United States and by 4.1% in the eurozone; it fell by 5.0% in Germany and by 3.6% in Spain. Latin America experienced a GDP growth rate decline of 2.2%; specifically, 1.5% in Chile, 0.2% in Brazil, and 6.5% in Mexico. Growth estimates in the most dynamic emerging economies were revised for 2009 (GDP growth rate of 8.7% in China and 5.7% in India); while for Russia, a significant fall of 7.9% in 2009 was foreseen.

The advanced economies are experiencing a strong restructuring process in their service sectors. Financial activities were redimensioned following the shutdown of investment banks and their absorption by commercial banks. As a consequence of the reduction of financial activities, job loss has increased and branch networks are being restructured. It is estimated that up to January 2009, about 325,000 jobs were lost in the global banking system, and 20 banks have declared themselves bankrupt in Europe. In the U.S., 25 banks failed in 2008 and 140 in 2009, while only 11 banks failed in the five years prior to 2008.

At the heart of the crisis is the restructuring of industrial activities in developed and emerging countries. In the eurozone, a rapid decline in industrial production took place during the second semester of 2008 and continued in 2009. Eurostat reported that in April 2009, compared to the same period a year ago, European industrial production fell by 21.6% in the eurozone. Industrial production declined in all EU member countries: 24.2% in Italy, 23.2% in Germany, 21.2% in Sweden, and 19.7% in Spain. In the U.S., on a year-to-year basis, industrial production fell by 13.4% in May 2009 and manufacturing output declined by 15.3%. Activities in sectors such as automobiles, office and telecommunication equipment, consumer electronics, construction, ceramics, textiles and garments, and food processing have sharply reduced their production.

In emerging economies, industrial restructuring is also taking place because of the sharp contraction of international demand, foreign trade, and direct investment. In China, a noticeable slowdown in the growth of industrial production can be seen, dropping from 22.9% in 2007 to 9.3% in 2009. Furthermore, thousands of companies have closed down, especially in the provinces of Guangdong and

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Zhejiang; and the steel, car, petrochemical, and textile sectors are, as the Chinese authorities recognize, in need of profound restructuring. In Korea, industrial production has fallen since October 2008, as indicated by the reduction in car sales and exports.

According to the International Labour Organization, unemployment is increasing as a consequence of the recession of the international economic system, and an increase in global unemployment of over 20 million was expected for late 2009. The IMF (2010) report stated that the unemployment rate in the United States was 5.8% in 2008, and was estimated to worsen to 9.3% in 2009 (and 9.4% in 2010). Unemployment also rose in the eurozone during the second semester of 2008, and this trend was estimated to continue throughout 2009, reaching 9.4% at the end of the year (and 10.5% in 2010). In Spain, which has the highest unemployment rate in the eurozone, the unemployment rate was forecasted at over 18% in 2009 (and 20% in 2010). In the emerging economies, unemployment is on the rise because of plant shutdowns. In China, the unemployment rate was 9.2% in 2007, and the situation was expected to worsen if the growth rate of the economy fell below 8% in 2009 because the capacity of the economy would be reduced for the absorption of new workers in the labor market.

The global crisis is having a significant effect on international trade, reducing exchange not only between developed and developing countries, but also in the South–South trade that was so dynamic in the previous decade (particularly intra-Asia trade). According to the IMF *World Economic Outlook* of April 2010, exports were estimated to fall in advanced economies by 11.7% during 2009; whereas in emerging and developing economies, exports were expected to fall by 8.2%, with variations from country to country (IMF, 2010). The OECD (2009) forecasted that exports would fall by 10.5% in Brazil and by 5.6% in the Russian Federation, whereas they would grow by 5.4% in China and by 3.1% in India.

The fall in international demand and the financial restrictions have reduced trade in all productive activities, mainly in manufacturing, and have provoked a fall in commodity prices and therefore in the

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terms of trade. Among the activities most affected are automotive parts, office and telecommunication equipment, electronics, and textiles and clothing. According to UNCTAD (2009), commodity prices have fallen since mid-2008, particularly for vegetable oil and seed oil (with a fall of 48% between the peak of 2008 and January 2009), agricultural raw materials (36%), and crude oil (petroleum) (67%). Yet, the terms of trade vary from one country to another, according to the merchandise trade balance; thus, the terms of trade were foreseen to increase in India by 1.8% during 2009, while decreasing in the Russian Federation by 22.5%.

If the spread of the worldwide crisis through the fall in commercial exchange is important, then the impact of direct investments is also important since many firms are revising their investment plans. UNCTAD (2009) stated that FDI inflows in 2008 fell by 15% with respect to the previous year. The developed countries were particularly affected, with a fall of 25% with respect to 2007, as a result of the credit crunch and the liquidity contraction of the financial system. In developing countries, however, direct investment inflows grew in 2008, albeit at a lower rate than in 2007.

The forecasts for 2009 indicated that direct investments would continue to fall, particularly in developing countries. These estimates and previsions are not, however, generalized for all countries and territories, given that much depends on the strategies and objectives of each of the firms (UNCTAD, 2009). As a result of the world economic recession, many large MNCs have cut back their plans for expansion and have stopped investing in order to improve the availability of the firm's liquidity. In contrast, other firms have shown a different behavior due to the investment opportunities that the fall in prices of assets and industrial restructuring have presented, as well as the spread of new activities related to the energy and environmental industry.

Direct investments from developing countries have shrunk, although less than in developed countries, due to the growing presence of Southern MNCs, the availability of large sums of foreign currency, and the resources of the sovereign wealth funds (Casanova, 2009). Chinese firms have not suffered any important crisis thus far,

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although they have diminished their foreign investments or, as Hutchison Whampoa Ltd. has done, announced the suspension of new investments abroad. In fact, China is taking advantage of its large reserves to insure the supply of natural resources from Africa and Latin America, and so has given Petrobras a loan of US$10 billion for prospection and explorations in new petroleum fields in Brazil.

Latin American firms are continuing their internationalization process, especially those in Mexico and Brazil, who are competitive in cement, steel, oil and gas, biofuel, software, petrochemical, and food industries. At the present time, many of these firms are taking advantage of market opportunities, as in the case of the Mexican firms América Móvil and Telmex, who bought under good condition the assets in the area of Bell Canada International, MCI WorldCom, and AT&T Latin America. Their investments in their own Latin American markets are also increasing. Thus, the Chilean group Luksic, who had sold Banco de Chile to Citibank, has bought it again; and the Brazilian bank Unibanco has merged with Banco Itaú, thus becoming the 10th largest bank worldwide.

Economic and Territorial Diversity

As we have just seen, during the past 25 years, the process of economic integration has accelerated and the competition between firms, countries, and regions has increased. This has induced the adjustment of productive systems, the transformation of labor markets, an increase in income, and an increase in the population's standard of living in many of the territories. However, this type of generalization is scarcely valuable, for there is in fact a multitude of situations in localities and territories that reflect the complexity of the economic, social, and institutional systems, as shown by the discussion on the ongoing global crisis.

The economic dynamics of cities, regions, and countries are very different from each other. Each locality or territory has a set of material, human, institutional, and cultural resources that jointly constitute its development potential. Therefore, at any given territorial

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level, one can find a determined production system, labor market, entrepreneurial capacity and technological knowledge, natural resources, social and political system, and historical and cultural heritage. Every economy articulates its processes of growth and structural change based on its development potential. Moreover, as a consequence of market exchange between firms and the other economic actors, very different results are obtained, which establish a great variety of economic, political, and social situations as well as projects and processes.

The economic, institutional, and technological changes of the last quarter of the 20th century have led to an in-depth transformation of the production system. The changes in taste and demand have meant a divergence from the existing range of products supplied by firms, altering the competitive capacity of regions and cities in poor and rich economies alike. The relative increase of production costs (above all, of labor and energy) has affected the firms' production functions and provoked the shutdown of industrial firms, the change in location of production activities, and the increased competitive advantages in some of the local productive systems. The deconcentration of productive functions, the increase in subcontracting, and the expansion of financial and business services have in turn introduced new changes in the economies and production systems of cities, regions, and countries.

The results have differed from one economy to another, depending on the capacity of each territory to respond to these new challenges. Research studies suggest that the factors which have determined the processes of structural change and economic growth are the diffusion of innovation through the productive fabric; the skill of human resources; the learning capacities of entrepreneurs; the transformation and adaptation of institutions; and the integration of firms, cities, and regions into competitive and innovative networks on a national as well as international level.

Globalization is accelerating productive adjustment and the processes of economic development, creating a new territorial system in the new global economy that some have termed "the economy of the archipelago" (Veltz, 1996) and that others prefer to call a new

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international division of labor. This spontaneous process that economic, social, and political actors engage in has made the economic and territorial systems more diverse. New products have appeared, some production lines have differentiated themselves, and the territories have adopted new economic and productive functions. The urban and regional system is becoming increasingly polycentric, and regional and urban hierarchies tend to be reduced to the degree that relations and networks of firms and cities intensify, precisely as a consequence of the effects of globalization.

The production system of the most dynamic cities and regions, on which the global economy rests, is more diversified now than during the years of the Cold War. It is formed by high-technology industrial activities (such as microelectronics, biotechnology, robotics, and aerospace industries) — those manufacturing activities that in the 1950s and 1960s were characterized by their standardized production methods, but were subsequently restructured and their production differentiated through the introduction of innovations (such as in the garment and car industries), advanced service activities (such as marketing, design, and technical assistance), financial services, and cultural and creative industries (including leisure, the performing arts, museums, and the print and electronic media).

The increase and diversification in the production of goods and services, and hence in those activities that foster and stimulate the production system, have diversified the territorial system. There are two processes that explain this. On the one hand, the conversion of national urban systems into a European or Latin American urban system (i.e. into global urban systems) has introduced a change in inter-urban relations that has transformed the systems of prices and costs, as well as a change in entrepreneurial and political relations at the global level. As a consequence, the conditions are created for a greater diversity of economic, political, and organizational functions of the cities and regions within a more closely related and interactive system. On the other hand, the increase in the variety of products and activities has reduced the capacity to concentrate productive and commercial functions in one city or urban region due to diseconomies of agglomeration. This dynamic generates the formation of more

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flexible urban systems and a reduction in the hierarchy of already-existing ones.

The increased diversity of territories and production systems can be appreciated particularly in the dynamics of the rural areas, in both developed and developing countries, which have experienced a period of ever-more complex adjustments as a result of the crisis in traditional agriculture, depopulation, the lack of basic infrastructures, and the pollution and contamination of the environment. Rural development presents a special problem in a world where the international division of labor is changing. In this new framework, everything seems to indicate that for the rural areas the best option is to specialize in productive activities, including non-farm businesses and specific services, in which they have a competitive advantage in national and international markets.

When the differentiation of rural territories is analyzed as a function of their integration into the international economic system, of the distance to markets and the capacity to learn on behalf of the local society, a great variety of situations appear. Remote rural areas, such as the Amazon, Tibet, and Sub-Saharan regions, made up of isolated territories with fragile production systems, frequently show a low-density population (sometimes aged) which relies on natural resources and a historical and cultural heritage that are constantly deteriorating. Therefore, the possibilities of entering into a path of self-sustaining development, using their own resources, are very limited. In the marginal zones of metropolitan areas, such as some peripheral districts of New York City or Caracas, which are physically well integrated into the international markets, insufficiencies in terms of the knowledge accumulated in institutions and firms and in terms of the citizens' and enterprises' capacity to learn are notorious. This limits their development potential and restricts the process of development. On the other hand, in those regions which are not well connected to markets but have a significant development potential, such as the Orinoco region in Venezuela, local actors can make use of the resources and capacities that exist in the territory and integrate the territory into the global economy. Lastly, in rural regions with a

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high innovative capacity that are integrated into the global economy through multiple network systems (productive, commercial, and technological), entrepreneurial capacity and the flexibility of their institutions allow for the generation of a large number of entrepreneurial projects and, therefore, the articulation of development processes that have their own dynamic.

Likewise, industrial spaces are very diverse, as pointed out by Markusen (2000), among others. If cities and industrial regions are analyzed as a function of the organization of the production system (large firms vs. networks of firms) and of the degree of integration of the enterprises into the production system of the territory where they are located, one can identify a variety of development patterns showing very different paths of growth. Among these, the following stand out:

- Local production systems formed by firms that are connected with each other and whose productive activities are integrated into the production chain of the city or region where they are located. The production system has a labor market that adheres to its own rules, and innovation and technical knowledge emerge and are diffused easily and well within the industrial district; the interaction between firms, in turn, creates externalities that link the local production system to the territory and whose effects on the firms' costs and profits are not reflected in the market prices. This scenario describes such innovative milieus as the Swiss Jura region and Silicon Valley in California, where local firms today enjoy an increasing competitive capacity in national and international markets.
- Local production systems whose firms carry out activities linked to production chains in other cities or regions, and where some of the important stages of the production chain (such as research and development or strategic business services) are produced outside the territory in which the companies are located. Good examples are the industrial districts such as Montebelluna in Italy, known for its production of footwear for mountaineers and plastic ski boots. The adoption of technological innovations has induced changes in

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the organization of the production process and the decentralization of some stages of production to countries in Southeast Asia. The entry of capital and companies from outside has driven the location of economic decision-making centers to other regions and cities so that, even though local production maintains its position within the chain, it has lost its independence.

- Local production systems formed around big enterprises that carry out all functions (or the most important ones) in the place where they are located, and whose activities are integrated into the local production chain. The leading companies buy from local and foreign providers and sell, mostly, to external markets. The labor market of the production system and the diffusion of technical knowledge are controlled by the dominant enterprise, and the main investment decisions are made locally. Turin, the seat of Fiat, is a good example of this type of production system. Another example is Vigo, a Spanish metropolitan area of less than 500,000 inhabitants located in Galicia, a region north of Portugal, where Citroën — whose plant is well integrated within the local productive system — and Pescanova — a local company specializing in frozen food products — lead the growth and structural change processes of the metropolitan area.
- Local production systems articulated around companies which are parts of external production chains and which lack significant local production links. The production system is dominated by big companies that use the space in which they are located like an enclave that allows them to carry out their own production and to maintain a system of economic and social relations. This is the case for independent companies or subsidiary plants, which produce for a multinational corporation. The relations within local firms are of little importance; the labor market is controlled by the foreign company, as is the diffusion of innovation and knowledge. Two good examples are the "Gran ABC" in the state of São Paulo, Brazil, where since the 1930s, with the arrival of General Motors, the car industry has been concentrated around one of the biggest multinational companies of this sector; and the Research Triangle Park in the United States.

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In sum, in a world characterized by the increased integration of economies and countries, the productive systems of both regions and cities have marked differences in their capacity for overcoming the global economic crisis. The progressive increase of competition stimulates the economic actors to make investment decisions that upgrade the local development potential with the objective of improving their market position and, at the same time, increasing the standard of living of the population. Economic diversity leads to different paths of growth for every one of them, taking them to different stages and levels of development. Globalization, therefore, establishes an open and undetermined game with a variety of paths of development, and this widens the possibilities for response and strengthens the diversity of the development processes of territories. This poses a challenge for economic recovery.

Inequality and Poverty

The process of economic integration has increased market competition and, for decades, has stimulated the economic growth and structural change of countries, regions, and cities immersed in the globalization dynamics. This has paved the way for the formation of an ever-more diversified productive and spatial system. However, economic progress does not affect all countries and territories to the same extent: income inequality continues to exist in developing countries, and seems to have worsened in Latin America and Sub-Saharan Africa during the 1980s and 1990s.

Inequality is an age-old problem that appeared on the international scene with all its severity during the 1980s, when, with the Soviet Union in full disintegration, society and the scientific community openly discussed the question of the standard of living of the population. For decades, traditional economic thought and international organizations had maintained the assumption that the income level of less developed countries would converge towards that of richer countries, supported by the idea that the growth rate of less developed countries was higher than that of more developed countries. Studies undertaken since the 1980s, however, show great

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inequality in the standard of living between countries and between regions, as well as the existence of large pockets of poverty in the less developed countries, especially in Sub-Saharan Africa, South Asia, and Eastern Europe, which are incapable of integrating their productive systems into the international economy.

Therefore, at present, it is largely accepted that, within the world economic system, an unequal distribution of income exists. The human development indexes published by the United Nations Development Programme show that the richest, most developed countries enjoy a development level that is more than two times that of the poorest countries (0.901 vs. 0.444 for 2006), a life expectancy at birth that is much longer (76.2 years vs. 48.4 years), a population with a much higher enrollment in education (87.6% vs. 46.5%), and a GDP per capita that is 20 times higher (US$25,100 vs. US$1,199 using the adjusted index).

The information and data presented by Summers and Heston (1991) and Maddison (2001) show that the differences in income have tended to increase in the long term, leading to a growing divergence between poor countries and rich countries. At the beginning of the 19th century, the GDP per capita in the richest countries was roughly three times higher than in the poorest countries, while currently it is about 20 times higher. Since the mid-1970s, the differences in the countries' GDP per capita levels have continuously increased. Between 1960 and 1990, the countries in which the richest 20% of the global population live increased their participation in the gross world product from 79.2% to 82.7%, while the countries in which the poorest 20% live reduced theirs from 2.3% to 1.4%.

Therefore, everything seems to confirm that a convergence between countries has not taken place, except in the case of developed countries and the most globalized emerging countries like China. The study by Milanovic (2001) on disparities of the per capita income, weighed by the population, shows that, if India and China are excluded, a convergence in the levels of per capita income occurred between the mid-1950s and the early 1970s — precisely during those years in which the level of economic integration diminished — and divergence has progressively increased since then.

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At the same time, it seems clear that convergence between the regions in the developed countries has taken place, as shown by the information regarding Japanese prefectures and the regions of the European Union (Barro and Sala-i-Martin, 1995). This allows us to speak of conditional convergence when economies share factors such as political, social and economic institutions, the level of education, infrastructures, and macroeconomic policies. However, amongst the developing countries, the situation differs greatly from one country to another. In Malaysia and the Philippines, the income inequality between households has diminished. But in Latin America, it has increased and continues to be very unequal, as shown by the Gini coefficient; in Brazil it was 0.590 in 2007, and in Mexico it was 0.506 in 2006. In China, where the number of poor people fell from 835 million in 1981 to 208 million in 2005, income distribution has worsened sharply since the beginning of the reforms in 1978, as the Gini coefficient — an increase from 0.33 in 1980 to 0.49 in 2005 — shows.

The disparities in income levels and the divergence between poor countries and rich countries conceal a very serious fact: in 2005, a total of 1.4 billion people lived below the international poverty line (on less than US$1.25 per day), according to Chen and Ravallion (2008). Poverty incidence is uneven across regions. It is most highly concentrated in South Asian countries (43.3% of the poor population in developing countries), in East Asia and the Pacific (23%), in Sub-Saharan Africa (28.4%), and, to a lesser degree, in Latin America (3.4%).

Absolute poverty reached close to 1.9 billion people in 1981, but has begun to decrease since then, especially in the most globalized emerging countries. In East Asia and the Pacific, poverty in absolute terms was reduced by more than 755 million people as a consequence of the effect of an improvement in the income levels mainly in China, whereas an increase of 47 million people took place in South Asia as a consequence of India's rising poverty. In Latin America, however, poverty increased during the 1990s to such an extent that in 2002 the level of absolute poverty surpassed that of 1981 by more than 16 million people, yet during the economic boom poverty declined.

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In short, if the developed countries and their regions are excluded, one can conclude that the countries' standard of living tends increasingly to diverge. Since the early 1980s, the number of poor people in less developed countries whose economies have grown at a rapid pace and are more integrated within the global economic system has been reduced, whereas it has increased in the case of less integrated countries with low growth rates. This divergence also remains in other dimensions of poverty, such as the life expectancy at birth, the degree of literacy, and the rate of school attendance.

The economy's incapacity to absorb new workers and the increased unemployment rate are having a negative effect on the living conditions of people, especially in those territories with a low per capita income. Over the last 30 years, poverty has decreased spectacularly throughout the world, and the number of poor people has fallen from 51.8% of the developing world's population in 1981 to 25.2% in 2005 (in Latin America, it fell from 11.5% to 8.4%). Nevertheless, the tide may turn in the near future if international demand is reduced, if the slowdown of global economic growth continues, and if the labor absorption capacity worsens. According to UN estimates, poverty was expected to increase to 150–200 million people during 2009 as a result of the impact of the crisis on the weakest economies.

Development and Economic Crisis

The ongoing global crisis emerged from the U.S. financial system and has progressively spread to the real economy, and its impact on advanced and emerging economies is impeding development processes. Thus, in order to foster economic recovery and promote sustainable development, public policy aims and strategies should be revised. Therefore, some questions should be answered. Which are the factors that explain the global economic and financial crisis? How did the diffusion from one place to another occur?

The current crisis follows a pattern similar to previous crises. Romer (2009) points out that, even though there are big differences between the current crisis and the Great Depression of 1929, mainly

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with respect to magnitude, there also exist noticeable parallels such as the decline in asset prices and the failure or difficulties of financial institutions, the contraction of production and greater unemployment, as well as the spillover to other developed countries and emerging economies. What is more, after the stock market crash of the 1930s, financial crises have been repeated in a systematic way and have intensified since 1971, when the Nixon administration decided to leave the Bretton Woods system of fixed exchange rates by ending the fixed dollar–gold convertibility rate.

In October 1987, an important stock market crisis took place, and in 1994 the Mexican crisis — known as the "Tequila crisis" — occurred. In July 1997, a significant exchange rate crisis originated in Thailand, with currency speculation spreading to Malaysia, the Philippines, South Korea, and Indonesia, leading to a strong recession that was associated with the rapid financial and capital market liberalization as well as with these countries' policies; it later spread still further to Turkey, Russia, and the Latin American countries. In 1999, the "dot-com bubble" burst as a consequence of speculation that developed around new information and communication technology companies. More recently, 2002 was the period of the Argentine *corralito* crisis.

A financial crisis results from the fact that, during a business cycle upswing, economic agents take excessive risks in the markets for goods, stock markets, foreign exchange markets, and in general for economic assets, leading to an investment boom financed with bank money (Minsky, 1977; Bordo, 2008; Ocampo, 2009). Stimulated by the availability of easy profits, investors turn to operations in which the price of assets goes above their real value, and their financial operations exceed their current income, leading to the formation of "bubbles" in markets and the overindebtedness of agents. The crisis leads to a collapse in asset prices, and the fall pulls economic agents and financial organizations down as well, leading to bankruptcies, the closure of banks and companies, and economic recession.

The ongoing crisis shows some unique features. The fall in housing prices in the United States during the first quarter of 2007 brought an interesting fact to light: the great expansion of credit

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occurred as a consequence of the creation of new credit instruments and the deficient regulation of financial markets. Perhaps the central point of the crisis was the fact that the collateralized debt obligations and the multiplication of assets coming from new financial intermediaries, which were not subject to the banking sector's regulatory controls, led to a strong expansion of credit, which in turn fueled speculation in financial markets. Moreover, financial liberalization changed the prerequisites that investment banks had to fulfill and allowed more financial intermediaries through non-bank agents; this increased the expansion of credit as the capital ratios of these entities were lower than those of commercial banks, which in turn enabled the former to dispose of more resources for engaging in speculative market activities.

In all, major changes in regulation and the lax oversight of the financial system permitted the formation of the financial and housing market "bubbles" (Tamames, 2009) in which a complex network of agents was involved. Lenders granted mortgages with great ease; investment banks and hedge funds transformed these into products that were attractive in financial markets; and fund managers bought these new assets with borrowed capital. This pyramid scheme, the fruit of speculative activities, collapsed as a result of the fall in housing prices, which left the mortgage value above the true value of real estate, leading the mortgage takers to stop their payments and return the assets to the financial entities instead.

The bursting of the real estate "bubble" led to a strong contraction of credit. On the one hand, the fall in the housing market and the collapse of the bonds' and assets' prices and returns affected banks, funds, and other agents who helped finance the boom. Additionally, the toxic assets had spread through a good part of the financial system, affecting not only the non-bank entities that participated in the network of agents who sustained the financial bubble, but also the commercial banks that were directly or indirectly contaminated by the toxic assets. The problem was made worse as the contamination of commercial banks spread mistrust and uncertainty in the interbank market, and so the price of interbank lending increased. The reduction of credit contracted liquidity and money in

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circulation, affecting the ability of companies and households to finance their investments and spending.

In market economies, the banking system is the cornerstone for the functioning of the real economy. The relation of companies with their suppliers and customers becomes more efficient due to bank-financed operations and transactions; also, households seek bank credit not only for their mortgages, but also for financing some of their consumer spending. Therefore, the contraction of credit caused by the financial crisis has provoked a reduction in the investment and consumption demand, leading to a contraction of production activities, the closure of companies, a rise in unemployment, and an increase in inequality and poverty, as pointed out before.

The financial crisis has led to a global recession because developed and emerging countries are closely linked to the global economy by trade and direct investment. The banking and stock market systems of developed and emerging economies were affected by the financial crisis, to a greater or lesser degree, through the interbank market, the activity of financial fund managers, and the flow of direct and portfolio investment in international markets. Furthermore, the crisis has had a strong impact on emerging economies through other channels that connect their economies to those of the developed countries. Ocampo (2009) points out that in Latin America the remittances of migrants are diminishing as a consequence of the contraction of international production activities, and the terms of trade are deteriorating in those countries that export agriculture, mining, and energy products.

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