Globalisation, Trade and Development

What is left for aid to do?

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Executive Summary

This paper reviews current thinking about the role that globalisation and trade has on development, and what that means for aid. The opportunity to undertake the review was made possible through a Public Service Commission Fellowship. The views expressed are not necessarily official views of AusAID.

The first section of the paper provides some definitions of globalisation, with the most succinct being "the tsunami of ever more interdependent financial and trade flows as well as of ideas and people". The section notes that globalisation is not new. And nor is it a distinctively American phenomenon. The current scale of globalisation is canvassed, as well as some of the main reasons why the pace of it is increasing. It is noted that developing countries have been actively – but not uniformly – engaged in these large economic trends associated with globalisation.

Section two (commencing page 8) reviews the latest findings on how globalisation affects development. Virtually all studies find that countries that trade more grow faster. Furthermore, it is also found that no country has achieved rapid and sustained growth in living standards without using the international economy and integrating with it. This high correlation between trade and growth is also illustrated by the specific experience of countries, including China and the Republic of Korea (pages 9 and 10)

But correlation is not causation. Liberal trade policies might cause economic growth, as some claim to show. Or increased trade might be a consequence of growth. Or there may be – and usually are – a range of a range of economic reforms occurring simultaneously so that it is difficult to disentangle the specific role of increased trade on growth. In brief, while the correlation between trade and economic growth is tight and clear, it is still difficult to establish rigorous or proven, one way, relationships between trade and economic growth.

While it is not possible to make absolute statements about globalisation and growth it is possible to see how, in the right circumstances, trade can contribute to economic growth (pages 11 - 12). Imports – not just exports – are an important part of the equation (pages 12 – 14). And, while there are clearly examples where globalisation has contributed to increased poverty (the Asia financial crisis, and Russia) there are also important and compelling examples where greater integration in the international economy has significantly contributed to poverty reduction, reduced inequality, and the broader development process (pages 14 - 20). Importantly, much depends upon the policy choices made by developing country governments. The varying development experiences of China, Vietnam, Indonesia and the Philippines are examined in this light.

Section three of the paper argues that while, on balance, globalisation can offer opportunities for developing countries the actual process of engaging in the international economy is not easy (page 21). Nor is it automatic (page 21 – 22). There are structural, policy, and institutional constraints within the developing country (pages 22 - 24). And there are trade barriers and distortions imposed by developed countries – and other developing countries – that target the very products that developing countries are most keen and capable to sell (page 24). Case studies of the distortions to the international trade of sugar and cotton are canvassed, and the adverse trade and developmental implications highlighted (pages 25 - 27).

What, then, is the role of development assistance? Section four addresses this issue. Can aid really play a part in the development process when it is so small compared to the much larger economic flows associated with globalisation? Total world wide aid at $US 50 billion is, for example, dwarfed by the total value of developing country exports of $US 2 trillion. And each year industrialised countries provide over $300 billion in support to their own agricultural producers – roughly six times the amount they spend on aid (pages 28 - 29). And aid is also usually very small in comparison to the economies and populations it is engaged with: total aid received by Indonesia is just over one per cent of its total economy and is the equivalent of just $US 7 per person per year.

But aid can be the critical catalyst to the development process. Its impact occurs not so much through the financial resources that it adds - which, as noted, are small - but through its capacity to stimulate change and reform. For example, it can help shape and support broad policy, legal, institutional and service delivery reform in developing countries in ways that trade and finance simply cannot do. Small, but well designed, aid interventions can strengthen the physical, social, and institutional infrastructure that is the necessary foundation for development and broader engagement with the international economy. Aid is not so much about adding "resources" as such as it is about adding value to the reform and development process that most developing countries are grappling with (pages 29 – 30).

This section concludes with a snapshot of how Australian aid specifically interacts with various aspects of globalisation and the trade and development process. It shows how Australian aid directly responded to the pressures arising from globalisation during the Asian financial crisis both in terms of causes and consequences (pages 31 - 32). Australian aid has also provided the technical assistance and capacity building needed to enable developing countries to engage in organisations such as the World Trade Organisation. As the case study of China shows (pages 33 – 35) this has then enabled such countries to get better access to world markets and enjoy a more predictable, rules based, approach to trade dispute resolution. But the even more significant impact on the longer term development process might be the way membership of such international organisations requires, and consolidates, deeper policy and institutional reform in the developing country.

Australian aid has also contributed to building up the capacity and developmental impact of structures "behind the border" that enable those countries to engage in trade and growth (page 35). In terms of physical infrastructure, for example, Australia has substantially supported PNG efforts to maintain the Highlands Highway across which some 65 per cent of PNG's imports and all of its coffee (PNG's most valuable agricultural export) travel. Australian aid helped halve the travelling time on key stretches of this road (page 36). Similar impacts are examined in agriculture (page 36) education (page 37) and health (page 38).

The contribution Australian aid has made to the broader issue of institutional development, capacity building, policy engagement and governance in our region – all issues critical to improved trade performance as well as the broader development process – is canvassed on pages 39 - 41.

The paper then seeks to draw the various threads together (pages 42 – 44). It concludes that globalisation presents a major opportunity for developing countries. Foregoing that opportunity is a high risk strategy: no developing country has achieved sustained economic or social development without engaging in the broader international economic environment. But engaging in globalisation also has real risks, and winners and losers. Successful engagement in the international economy is not easy. Nor is it automatic.

However at the heart of successful engagement in globalisation are the policy choices that developing country governments make. And that is where aid programs have a clear comparative advantage and contribution. Even relatively small amounts of aid can help shape policies, institutions, capacities and environments in which a developing country can engage in the development process.

Good development contributes to a prosperous, stable, and secure region. That is in the national interest of developing countries. And it is in the national interest of Australia.

Globalisation: definitions and context.

Globalisation: definitions, what it is, and what it is not.

"Globalisation has joined imperialism, colonialism, capitalism and communism in becoming an all purpose tag, which can be wielded like a club in almost any ideological direction. It is the defining political economic and social phenomenon of the new millennium". So says Mike Moore, previous Director General of the World Trade Organisation (WTO)[i].

But what is globalisation? There are many definitions. Mike Moore has the most concise description: 'the tsunami of ever more interdependent financial and trade flows as well as of ideas and people" [ii]. All other definitions, be they from the World Bank[iii], the IMF[iv], the OECD[v] or other sources have as their common thread the increasing economic integration between countries across the globe especially through trade and finance[vi].

Globalisation is often portrayed as something rather new. This is not the case[vii]. The World Bank[viii], for instance, identifies three major waves of globalisation: the first being from 1870 to 1914 driven by falling transport costs; the second wave from 1950 to 1980 driven by falling trade barriers and further falls in transport costs; and a third wave from 1980 which involves distinctive features of even greater financial flows and integration; the IT revolution; and the greater involvement of many developing countries in trade in manufactured goods and services.

Many commentators make the point that globalisation is not inevitable and can be reversed – but with high economic, social, and political costs. Mike Moore, for example, argues that the globalisation we see and hear of so much today is not an aberration. Rather:

> *"The aberration was how world trade was stopped in its tracks as a response to the Great Depression (which) was made deeper, more prolonged and more lethal by the outburst of protectionism and economic nationalism…. Escalating trade barriers, competitive devaluations, and economic nationalism contributed to the volume of international trade falling by one third between 1929 and 1933…. That, and the vindictive Versailles treaty provided further justification for future European nationalism and vicious tribalism. From all this came the twin tyrannies of the last century – Fascism and Marxism. Both protectionist, nationalistic and murderous."* [ix]

Globalisation can also be portrayed as something particularly or distinctively American: the 'Coca - Colanisation' of developed and developing countries alike, with the United States driving the process. This, however, is a caricature. The United States is itself subject to the same dynamics of globalisation as other countries. For example, only 37 per cent of the production cost of an American car is now actually generated in the US: the rest is drawn from inputs from nine other different countries[x]. The US is also the largest *recipient* of foreign direct investment in the world. In August this year Toyota sold more cars in America than Chrysler (itself now owned by Daimler Benz, the makers of Mercedes). In September 2003 it was announced that another icon of American manufacturing, Levi Strauss, would produce all its garments offshore and no longer manufacture in US. The list goes on.

Indeed, in many ways the modern 'face' of globalisation is itself becoming less American or European and more internationalised. A World Bank study notes for example that Cambodia has become one of the fastest growing garment exporters in the world, growing from $US 26 million in 1995 to over $1 billion in 2002. The study notes:

> *"Cambodia is today an established supplier of low price, medium quality garments, employing around 220,000 workers in 185 factories out of which only 23 are Cambodian owned. Almost 90 per cent of the garment manufacturers are foreign owned, coming from Hong Kong (China), PR China, Singapore, Taipei, South Korea, Malaysia, Thailand, Indonesia, Bangladesh, England, Germany, Australia, Canada and the US*" [xi]

And, of course, there are a myriad examples involving Australia: for the last three years all "Streets" iceblocks – yes iceblocks - sold in Australia have actually been made in China and exported here[xii].

Globalisation – the current scale, causes, and the involvement of developing countries.

Evidence of increasing economic integration across the globe is not hard to find. The volume of world merchandise trade has increased 18 times since 1950, and the ratio of world exports to world production has doubled. And the trend is larger, and even more pronounced, with respect to finances and capital flows: the average *daily* turnover in foreign exchange markets has grown from about $US 200 billion in the mid 1980s to more than $US 1.4 *trillion* per day now.

Developing countries have been actively, but not uniformly, engaged in these large economic trends. Over the last two decades, for example, developing countries as a group have increased their share of global trade from just under one quarter to about one third [xiii]. The nature of that trade has also changed: manufactured products rose from less than a quarter of developing country exports in 1980 to more than 80 per cent by 1998 [xiv]. And some 24 developing countries – with 3 billion people – have doubled their ratio of trade to income over the past two decades[xv].

But participation by developing countries in globalisation is by no means uniform: Sub Saharan Africa's share of world trade fell from an already small 4% in 1987 to just 1.3% ten years later. And South Asia – where well over one billion people live - halved its share of world merchandise exports from 2.6% to 1.1 % over the same period.

What has been driving the trend to increasing economic integration ? Analysts point to three things. First is the deliberate, progressive reduction of many – but not all - barriers to trade. Average tariffs at the end of the Second World War have, for example, been reduced from 40% to 4% now[xvi]. Liberalisation of the goods market was then followed in more recent years by liberalisation of capital and financial markets in many countries.

A second factor has clearly been technological progress that has driven down the costs of economic engagement in the world. As just one example, a three minute phone call from New York to London in 1930 cost the equivalent of $293 in current prices but now cost around 30 cents for a better connection.[xvii]

A third factor is the experience of countries – especially developing countries – compared to those of others. For example, after decades of slow growth under protectionist policies, India faced a financial and economic crisis in the early 1990s. That crisis, and India's recognition that more open economic policies had been a contributing factor to China's rapid economic growth, helped push India towards more liberal and open economic policies. Similarly, the successful reform experience of Ghana has been found to play a notable role in Uganda's own generation of ideas and reforms[xviii].

The impact of globalisation on development: the latest findings.

Globalisation is clearly a major economic phenomenon, with substantive implications for developing countries. Indeed, the Chief Economist of the World Bank has argued that "*the single most important development* in the world economy in the past 20 years has been the shift of India and China toward more outward oriented development strategies and the freeing of entrepreneurial spirits"[xix].

But is there evidence that globalisation and openness to trade contributes to development, particularly in light of the Asian financial crisis, or the sombre economic and social impacts of globalisation on the former Soviet Union? This question has been the subject of numerous studies. The following summarises some of the latest findings.

Growth and trade go together

Virtually all studies find that countries that trade more grow faster. For example, a recent World Bank study of 72 developing countries found that since 1980 the 'globalisers' – those that had increased their ratio of trade to GDP – grew at almost four times the rate of 'non globalisers'. More specifically, the Bank found that some 24 'globalising' developing countries – and especially Brazil, China Hungary India and Mexico – have increased their per capita growth rate from 1 per cent in the 1960s, to 3 per cent in the 1970s, 4 per cent in the 1980s and 5 per cent in the 1990s. Their growth rates now substantially exceed those of the rich countries. In contrast, the Bank concludes "much of the rest of the developing world – ie the non – globalisers – with about 2 billion people – is becoming marginalised. Their aggregate growth rate was actually a negative one per cent in the 1990s"[xx]. The Bank concludes that "as far as we can tell there are no anti – global victories to report for the post war third world"[xxi].

OECD studies support the link between trade and growth, adding the flip side of the coin that "there is certainly no coherent body of evidence that openness is bad for growth"[xxii]. Anne Krueger concludes "no country has achieved rapid and sustained growth in living standards without using the international economy and integrating with it"[xxiii].

There is also a rich field of academic studies on the relationship between trade and growth. Perhaps the most well known is David Dollar's 1992 study entitled "Outward oriented developing countries really do grow more rapidly – evidence from 95 LDCs 1976 – 85"[xxiv]. Another major study was the influential study[xxv] by Jeffrey Sachs and Andrew Warner which found that open economies grew by 2.4 percentage points per year faster than those that were not open: clearly a significant difference.

Other scholars dispute these findings, arguing that the Sachs, and World Bank, studies do not sufficiently strip out other complicating and confounding factors that affect economic growth.

Rodrik, for example, argues that once issues like overvalued exchange rates, macroeconomic instability, and geographical location are disentangled from the equations then the relationships claimed by the pro – globalisers breaks down. He further argues that there are several important examples where "open" economies have failed to grow, and where import liberalisation followed, not preceded, sustained economic growth. Rodrik makes a good case for caution and scepticism about the more breathless claims for globalisation and the more ideological approaches that can accompany it.

But even a well informed sceptic of globalisation like Rodrik, who argues that the benefits of trade openness are now greatly oversold, agrees that "no country has developed successfully by turning its back on international trade and long term capital flows". He also agrees that "certainly there is scant evidence from the last 50 years that inward – looking economies experience systematically faster economic growth than open ones"[xxvi].

And growth and trade go together at the individual country level across time.

Such cross – national studies are consistent with the development record of individual countries.

China is an obvious example. From the economically dysfunctional period of the Great Leap Forward and the Cultural Revolution, China has emerged as "the most dynamic large player in the world economy"[xxvii]. The World Bank estimates that China reduced the number of people living in poverty from 360 million in 1990 (shortly after the opening of its economy and other reforms) to about 210 million by 1998.[xxviii] And the actual proportion of the population living below $2 a day fell from 70 per cent in 1990 to less than 40 per cent in 2002.[xxix] The reform process involved many components, including major domestic agricultural reform and rural industrialisation. But trade and economic engagement with the world were also important parts of China's reform process. As Professor Ross Garnaut notes:

> "*China's economy has expanded five times, and its foreign trade by twelve times, since the opening of that economy in 1978. It has greatly increased consumption levels of what had been about half of the world's people in poverty. Then an isolated, autarchic economy, China through the mid and late 1990s absorbed about half of the direct foreign investment flows to developing countries. From having no trade or investment ties with Taiwan and the Republic of Korea, it is*

> *now the first or second export destination of one and third of the other.*
>
> *Even greater has been the transformation of the Chines mind. Tens of millions of Chinese are now part of an international community of ideas and information. Personal security is provided significantly by the value of people's labour and produce in the market place, in the stead of an intrusive and overwhelming state. With the expanded role of the market had come a substantial widening of the sphere of personal freedom – to travel and communicate with others*."[xxx]

The Republic of Korea (ROK) is another example where trade – and certainly exports at the initial stages of the reform process - was part of a broad package of reform that saw fundamental, positive, and sustained transformation of the economy and society. The ROK's per capita income rose roughly tenfold in the four decades from 1950, based in significant part on opening to trade [xxxi]. Mike Moore, ex Director General of the WTO notes that in 1945 the north of Korea had the richest most industrialised part of the peninsula but "now South Korea is in the OECD while its other half in the north is an economic basket case"[xxxii].

Moore cites other examples, the common thread being that those countries that grew were those that were actively involved in international trade. He notes, for example that "thirty years ago Japan had developing country status"[xxxiii]. (The significance of this becomes apparent from the latest World Trade Organisation Annual Report which notes 'export success has been intimately connected with Japan's overall growth performance and export growth averaged 17 per cent per year for a sustained period up until 1973').[xxxiv]

Moore also notes that in 1960 Malaysia had the same income as Haiti. Their income per capita are now, respectively, $US 3300 and $US 480. Burma and Thailand living standards were the same after World War Two. Now the average Thai is 25 times better off, with an income per head of $US1940 [xxxv]. The World Bank is simply not able to estimate Burma's income per head but presumes it to be less than $US 735. Life expectancy in Thailand is now 69 years, but 57 years in neighbouring Burma.

In each of these cases, argues Moore, a key variable associated with economic and social development is successful engagement in and exposure to the world economy through trade and financial flows.

Rodrik and others, while agreeing that increasing trade as a percentage of GDP was associated with rapid growth in Asia, point out that a number of countries chose as a matter of policy to favour the *export* side of the trade equation. Countries like Japan, Taiwan and Korea adopted policies that quite significantly restricted (non essential) imports and were only gradual liberalisers. Indeed, some very protectionist practices still occur in areas such as Japanese restrictions on rice imports.

The causal links: does trade create growth?

In sum, virtually all studies show that increased trade is highly correlated with economic growth. And, conversely, no country has had sustainable economic growth without trade.

But correlation is not causation. Liberal trade policies might actually cause economic growth, as some claim to show [xxxvi]. Or increased trade might be a consequence of growth. Or there may be – and usually are - a range of economic reforms occurring simultaneously so that it is difficult to disentangle the specific role of increased trade on growth. In brief, while the correlation between trade and economic growth is tight and clear, it is still difficult to establish rigorous or proven, one way, relationships [xxxvii].

While it is not possible to make absolute statements about how trade contributes to growth, it is possible to see how, in the right circumstances, trade can contribute to the growth and development process.

Trade theory going back to Ricardo and Adam Smith has argued that 'undistorted price signals from world markets, in combination with the exchange rate, allow resources to be allocated on the basis of comparative advantage, thereby increasing productivity'[xxxviii]. Trade also allows economies of scales to be achieved and, of particular interest to developing countries, foreign debt to be serviced, labour to be absorbed in productive enterprises, and products, skills, management and access to markets imported.

The World Trade Organisation puts it succinctly when it says

> *Changes in relative prices brought about by trade liberalisation will lead to a reshuffling of resources from less competitive import competing sectors to competitive and expanding export sectors. It is these shifts of resources into more productive activities that raise the economy's efficiency and create benefits from trade*[xxxix]

And the World Bank puts it this way

> *A country's trade policy is a key link in the transmission of price signals from the world market to the national economy. Undistorted price signals from world markets, in combination with an exchange rate that reflects macroeconomic conditions, encourages efficient resource allocation consistent with comparative advantage. An open trade regime gives*

consumers and firms access to a greater variety of goods and services, including capital and intermediate goods, and contributes to productivity growth through access to global technology and by forcing domestic firms to become more efficient.[xl]

This last point is important. Trade provides both the *means* to grow (through access to competitively priced goods, capital, technology) and the *incentive* to improve productivity (through competition on the world economic scene). This is well summarised by the experience of China:

"Even in historically closed economies such as China, which was far from completely open during the early reform period, high growth was fuelled in part by increased access to international capital markets and markets. Where local conditions for entrepreneurship and growth are good, exposure to international competition increases the productivity of domestic firms and lowers input costs for downstream users, while foreign direct investment brings with it new productions and process technologies, organisational capacity building, and marketing networks"[xli]

It is not just exports: imports and internal liberalisation matter too.

The modern experience of developing countries experience with globalisation and trade reinforces an important point well understood by Ricardo and Adam Smith: that imports play an important role in the development, growth, and overall competitiveness of an economy.

It is a false, and ultimately unsustainable, strategy to pursue mercantilist approaches that see exports as 'good' and imports as 'bad'. This is borne out by recent research. Robert Lawrence, Professor of International Trade and Investment at the Institute for International Economics, analysed those developing countries with sustained high economic growth (defined as those economies averaging 6 per cent growth per annum over a decade or more). He found that in 47 out of the 50 cases examined, imports had grown faster than the 6 per cent average growth for the economy as a whole [xlii]. One conclusion to draw from this is that increased import penetration was as much a factor associated with sustained growth as export growth.

Globalisation sceptics such as Rodrik are right to say that import liberalisation has often been a second or subsequent stage of integrating with the world economy. But Lawrence's findings debunk the populist view that while export growth is to be applauded, imports somehow represent a 'loss' to the economy and should be minimised.

The idea that imports – not just exports – are an important part of a growth and development strategy is born out not just at the national level but at the industry specific level as well. The World Trade Organisation cites, for example, an interesting comparison between the electronics and the automotive industry in Malaysia[xliii]. Malaysia's electronics industry received little tariff or non – tariff protection and, combined with a liberal investment regime, attracted significant inflows of foreign investment. The competitive environment resulted in electronics now accounting for almost half of Malaysia's exports and the industry being one of the main engines of Malaysia's growth. The industry was the largest contributor to Malaysia's manufacturing output, employment, and exports. Output growth of 22 per cent was recorded in 1999 and almost 32 per cent in 2000. Its international competitiveness was demonstrated by the fact that Malaysian exports of electronics were able to capture over 2.5 per cent of global electronics production.

This contrasts with the experience with Malaysia's domestic automotive industry. In Malaysia, the automotive industry has been relatively sheltered from foreign competition with tariffs on automobiles ranging from 42 per cent to 300 per cent and most automotive parts and components subject to a 25 – 30 per cent tariff. Non tariff measures also apply. While capturing a large part of the Malaysian domestic market behind such protective barriers, few Malaysian cars are sufficiently competitive to be successful on the export market: exports of automotive products accounted for less than one half of one per cent of Malaysia's total exports in 1999.

In brief, protection against imported cars and their components had, in effect, "taxed" the competitiveness of the Malaysian car industry and prevented it from being competitive in the international market place. The opposite had happened in the case of electronics. Such consequences have important implications for the choices governments make about development policies.

A very recent and interesting review[xliv] of almost 900 manufacturing firms in India was also able to shed new light on the differences at an industry and company level between those firms exposed to international competition and those that are not. In essence, Daveri and others found that employees in firms subject to foreign competition are exposed to higher wage and employment variability. However they also enjoy a higher probability of being promoted and trained than employees of firms not subject to foreign competition, and this could be substantial as it affected the stream of earnings of a worker over a whole working life. Interestingly, while the strength of these associations was stronger in the case of Indian firms that were exporters, the findings also applied to Indian firms that were producing for the domestic market but competing against imports.

Such overall findings are consistent with the conclusion that 'for developing countries the principal requirement was not to open up others' markets but to open up their own"[xlv]. It is also consistent with the broader point made by Nicholas Stern, Chief Economist of the World Bank, when he noted that "nearly all analyses of the benefits or removing all global restraints to trade show that most of the gains to developing countries – some 60 – 80 per cent – come from reforms within developing countries themselves.[xlvi]

Noted trade economist Jagdish Bhagwati puts it well when he argues:

> *"We know from numerous case studies dating back to the 1970s (which only corroborated elementary economic logic) that protectionism is often the cause of dismal export, and hence economic performance…..just ask yourself why, though India and the far eastern countries faced virtually the same external barriers after the 1960s, inward looking India registered miserable export performance while outward looking South Korea, Taiwan, Singapore and Hong Kong chalked up spectacular exports. Just as charity begins at home so exports begin with a good domestic policy. In the near exclusive focus on rich country protectionism, this dramatic lesson has been lost from view".* [xlvii]

The broader links between trade policy and broader development strategies.

A constant theme of the latest studies on trade, globalisation and development is that broad success in trade, and especially export success, cannot easily be achieved in isolation from the rest of the economy. The level of inflation and other aspects of macroeconomic policy; the competitiveness of the exchange rate; the degree of flexibility in factor markets including labour markets; the efficiency and effectiveness of physical and institutional infrastructure and even the perceived levels of corruption in a country will all affect the capacity of an economy to engage in trade, and the competitiveness of its products and services. Good trade prospects require good economic fundamentals, good policies and good institutions. The exceptions – successful and sustained exporting of mineral or petroleum products from a resources enclave – tend to be just that: exceptions to the broader picture.

And there is a flip side to this: bad trade policy can overwhelm otherwise good domestic development policies. The OECD notes, for example, that:

> *'There are undoubtedly other equally important policies for development – eg education, infrastructure and macroeconomic management – but a bad trade policy is likely to reduce their beneficial effects, even possibly to the point of rendering them ineffective. A very restrictive trade policy probably permits other policies to get further out of line, and if trade policy is arbitrary and interventionist it affects the whole government / business relationship.* [xlviii]

Trade, globalisation, and poverty alleviation

Numerous World Bank and other studies show that substantial and sustained reductions in poverty simply do not occur in the absence of economic growth[xlix]. And, while trade is tightly correlated with growth, the impact this might have on poverty alleviation remains complex.

There are clearly cases where trade and integration with the world economy have demonstrably reduced poverty. For example, while a globalisation sceptic such as Rodrik issues the correct and cautionary note[l] that Vietnam opened its economy to import competition in a relatively slow and measured way, most would agree that Vietnam's broader engagement and integration with the world economy played a substantive part in economic growth and broader economic development for that country. The World Bank, for example, in analysing the experience of Vietnam during its period of reform and trade opening found that:

> *The income of the poor has risen dramatically and the level of absolute poverty has been cut in half in 10 years. 98 per cent of the very poorest households became better off during the 1990s. This improved well being is not just a matter of income. Child labour has declined and school enrolment increased. Vietnam's exports directly provided income earning opportunities for poor people: exports included labour intensive products such as footwear and rice which is produced by most low income farmers".*

More broadly, Hoekman concludes that there are many studies of how trade and openness contributed to growth and poverty alleviation for a range of countries (including Japan, the four tigers of South East Asia, Chile, and Mauritius). He also concludes "there are no examples of countries that have significantly reduced poverty without significantly increasing their exports"[li]

Similarly Anne Krueger, First Managing Director of the IMF, has argued:

> " *No country has achieved rapid and sustained economic growth without opening its economy to the rest of the world. Those countries that have been most successful at reducing poverty are those that have developed sound economic policies and enjoyed rapid economic expansion. And the pace of expansion is directly linked to the degree of openness to the rest of the world and the growth of trade. Of course sound economic policies, which must encompass well functioning institutions and investment in education and infrastructure are crucial. But as economies become more open, sound economic policies*

> *become more necessary, more effective – and easier to implement. A virtuous circle is created"* [lii]

There are, of course, clearly examples where exposure to globalisation has increased poverty. Stiglitz's account[liii] of the dramatic and adverse impact of poor economic policies – including poorly managed globalisation – had on Russia's economic and social fabric is sobering: in 1989 only two per cent of Russians were living below the poverty line of $2 a day. Just ten years later, following a failed attempt at domestic liberalisation and integration with the world economy, the rate of poverty had grown to almost 25 per cent. And if the slightly higher poverty line of $ 4 per day was used, then 40 per cent of Russians were in poverty, making it comparable to Latin American conditions.

The Asia financial crisis is also an important example of how the pressures and forces of globalisation can disrupt growth and increase poverty – at least in the short to medium term. In essence, open capital accounts in several countries in South East Asia had permitted excessive international borrowings. National regulatory policies and practices, including bank regulation and supervision of lending, were not strong enough to manage the large flows of capital or counter 'cronyism'. Too often the borrowed international capital went to poor quality investments, or real estate, rather than productive investments. When a crisis of confidence occurred, international capital was quickly withdrawn: in July 1997 in Thailand and then in August in Indonesia. Open capital accounts - the door through which international capital had entered over the years – became the same door through which international capital retreated, but this time in days and weeks.

While a major drought was also a factor exacerbating poverty – particularly in rural Asia - it is clear that the Asian financial crisis dramatically affected economic conditions in the region and this, in turn, exacerbated poverty through three main pathways: unemployment rose (by 50 per cent in the case of Thailand); prices of basic necessities rose; and public expenditure on basic services was squeezed.

Indonesia illustrates the situation. There, GDP – which had been running at around 8 per cent - fell to 4 per cent in 1997 and then declined by a very significant 13 per cent in 1998[liv]. Within the space of a year, the value of Indonesia's currency fell by 80 per cent and inflation soared to 50 per cent. Effects were numerous and widespread. Pharmaceutical prices doubled or trebled and availability of vitamin A tablets declined considerably from the onset of the crisis. [lv]. Little wonder that the World Bank concluded that ' no country in recent history, let alone one the size of Indonesia, has ever suffered such a dramatic reversal of fortune" [lvi].

The adverse effects of the Asia financial crisis cannot be underestimated. And while the situation was clearly grave, some of the actual impacts on poverty have been somewhat surprising. For example, a major independent study commissioned by AusAID on the effects of the Asia crisis on children found that: "while the impact on poverty and on children has been serious it was less severe than originally anticipated. In the three economies surveyed, most children remained in school and continued to access health services such as immunisation. Reports of an increase in the incidence of malnutrition are few and relate to exacerbation of problems that existed prior to the crisis"[lvii].

The report also found that although the contraction in GDP in Indonesia was worse than originally forecast, social impacts have been less dramatic especially due to family coping mechanisms and involvement with the informal economy. Indonesian studies found that while there were considerable differences between regions, 'the crisis hit the wealthy and middle income urban areas more than most of the rural poor".[lviii]

Similar observations with respect to the impact of the Asian financial crisis on poverty have been made with respect to other countries in the region. Some argue that the Philippines, for example, did not suffer the same degree of economic and social dislocation or rises in poverty levels as Indonesia essentially because it was less integrated with the world economy – an argument against globalisation. But the situation may not be as clear as that. It has been noted by Indonesian commentators, for example, that during the period of the Asia financial crisis approximately four out of five Filipinos had a relative working outside the country, and that overseas remittances became an important social safety net[lix] - something that would not have been available in the absence of wider economic engagement with the global economy.

More fundamentally, the lessons to be drawn about globalisations impact on poverty levels need to be viewed over the longer term. In the case of Indonesia, for example, the World Bank notes that "the last three decades had seen an unprecedented and steady decline in the poverty rate from over 50 per cent in 1970 to an estimated 10 per cent in 1997".[lx] While there were many factors contributing to this[lxi], one important component was a conscious strategy of integration with the global economy including especially encouragement of competitive, labour intensive, manufactured exports. The argument could be made that the Philippines – with a national poverty rate of 37 per cent now, compared to a rate of 27 per cent in Indonesia [lxii] - would have made greater inroads into poverty had it more judiciously and energetically engaged with the broader international economy over the longer term .

And while globalisation was a major trigger for, and transmitter, of the Asia financial crisis perhaps the principal factor explaining the recovery of those economies was itself a characteristic of globalisation: the ability and willingness of the United States to absorb increased exports at the time. More specifically, the competitiveness of exports from Asia increased significantly as a result of the dramatic drop in their exchange rates at the time of the crisis. The political willingness of the United States not to protect itself against such increased import penetration helped such countries trade their way back to growth. China's preparedness not to undertake competitive devaluations of its own also helped. But the key overall message is that open international economic systems, while part of the cause of the original problem, were also part of the solution.

Where does all this leave us in terms of sorting out how trade might affect poverty? In a useful article entitled "Trade and poverty: is there a connection?" Alan Winters traces through the various ways in which trade affects prices, incomes, employment opportunities and growth prospects for the poor.

Winter's study begins with a cautionary reminder about the methodological difficulties of trying to establish cause and effect between trade and poverty reduction:

> *If trade liberalisation and poverty were both easily measured, and if there were many historical instances in which liberalisation could be identified as the main economic shock, it would be simple to derive simple empirical regularities linking the two. Unfortunately none of these conditions is met so we are reduced to examining fragmentary evidence on small parts of the argument. For example, the fact that trade liberalisation in South East Asia was associated with great strides in alleviating poverty is not sufficient to show that it caused those strides: too much else was going on. Similarly the (mixed) evidence that liberalisation has gone with increasing poverty in Latin America since 1980 is not sufficient to prove the opposite*[lxiii]

But his analysis of the various pathways through which trade affects poor people – both positively and negatively, directly and indirectly – leads him to conclude:

> *In the broadest possible terms….trade liberalisation is generally a strongly positive contributor to poverty alleviation – it allows people to exploit their productive potential, assists economic growth, curtails arbitrary policy interventions and helps insulate against shocks. However most reforms will create some losers (some even in the long run) and some reforms could exacerbate poverty temporarily. In these circumstances, policy should seek to alleviate the hardships caused rather than abandon reform altogether* [lxiv]

Trade, globalisation and inequality

Despite the claims of anti globalisers the latest World Bank findings conclude that there is simply no evidence either way that increased trade is systematically associated with either increases, or decreases, in inequality.[lxv] Rather, what seems to happen is that the increased growth associated with open economies magnifies the underlying economic and social characteristics of the country. Thus, the benefits of trade induced growth in Latin America did tend to go to those (few) already owning land and similar assets, thus reflecting, but also exacerbating, underlying structural inequality that existed in the first place[lxvi].

But this is not always and automatically the case. The World Bank concludes:

> "*There are important examples, notably China, where opening has gone hand in hand with rising inequality, but this has not been a general pattern. In many developing countries – for instance Ghana, Uganda and Vietnam – integration with the international market has coincided with stable inequality or with declines in inequality".*[lxvii]
>
> *In the case of Vietnam for example, the share of the population in poverty (ie living below a 2000 calorie per day poverty line) was cut in half within a decade, from 75% in 1988 to 37% in 1998. The causal link was clear – Vietnam became a major exporter of rice, many of the poor were rice farmers, and as a result 98 per cent of farmers were better off six years after the opening and reform process started.*[lxviii]

In essence, the long term impact of globalisation on inequality in a country is a reflection of that country's economic and social structures. And these, in turn, are subject to policy and resource allocation decisions of government. Investments in public education, rural roads, competitive agricultural exports in rural areas and labour intensive manufacturing in urban areas all encourage sustained growth with equity

And, from a development perspective, it is essential also to recognise that rising inequality within a developing country might also be accompanied with substantial reductions in poverty. An International Labor Organisation study on the social dimensions of globalisation concluded, for example, [lxix]

> *In Bangladesh …income inequality increased (over the period of trade liberalisation). Yet in the same period the percentage of the population living below the poverty line gradually declined from 28 per cent to 25 per cent. These figures reflect an important decrease in poverty among the rural population while poverty among the urban population showed a slight increase*.

Chile went through a second phase of trade liberalisation in the second half of the 1980s that was accompanied by a marked increase in trade and investment flows. The ratio between the income of the 20 per cent richest households and the income of the 20 per cent poorest households first decreased from 13.3 per cent in 1987 to 12.2 per cent in 1992 and then increased to 13.8 per cent in 1996. Inequality thus increased in the second period. Absolute poverty, however, declined from 17.4 per cent of the population in 1980 to 12.9 per cent in 1990 and 5.8 per cent in 1996.

Globalisation: natural constraints, barriers, and policy mistakes.

The previous sections conclude that, on balance, international trade and integration with the international economy offer significant opportunities for developing countries interested in growth and development.

But maximising the benefits from globalisation is not easy. And it is not automatic. There are several constraints. And there have been some large scale and substantive mistakes made in the way countries engage with the global economy.

Structural characteristics, including natural resources: the "devil's gifts"

Reaping the benefits of trade and globalisation is not easy. Nor is it automatic. Pacific Island countries, for example, face the combined constraints of having small economies, long distances from markets and high transport costs. Integrating into the global economy poses special challenges for such countries. (But, as the car component factory in Samoa shows, it can be done.)

And countries rich in natural resources do not necessarily or automatically reap significant or sustainable benefits from integration with the global economy. Several countries, including some in the Pacific, have little that is positive or sustainable to show for their trade engagement in sectors like forestry or fisheries. Poor policies, weak institutions and regulations, and corruption have all combined to leave some island economies with the worst of all worlds: significantly underpricing of their forest and other resources but also at times irreversible environmental damage.

Furthermore, developing countries with rich mineral or petroleum "resource enclaves" may find such resources do not automatically transmit broader social and economic benefits throughout the developing country economy. In the case of Papua New Guinea, for example, mining and petroleum contributes almost one quarter of GDP, one third of government internal revenue, and three quarters of the value of all exports. And while such economic activity and revenue is clearly welcome from a budgetary point of view such resource enclaves may have only thin upstream and downstream linkages with the rest of the economy, including the rural economy where some 80 per cent of the population, and 94 per cent of the poor, live. [lxx]

Indeed, the experience of several African economies suggests that being endowed with significant natural resources can turn out to be "the devil's gifts". High income streams from resource enclaves exports raise the exchange rate, making the country's other exports – including possibly labour intensive manufactures that can help reduce poverty - less competitive (the so called "Dutch Disease" problem). Or political elites can capture the large economic rents associated with mineral and petroleum resources and spend them on wars, palaces, uncompetitive national airlines or Swiss bank accounts. Ironically, some economies that are least integrated with the global economy in terms of international trade are quite well integrated in terms of international capital flows – to the detriment of the country. The World Bank notes that by 1990 about 40 per cent of Africa's private wealth was held outside the continent[lxxi].

Complementary factors, including good physical, social, and institutional infrastructure.

In brief, therefore, the evidence shows that engaging in globalisation is not an easy, or an automatic, pathway to growth. Several complementary things need to be in place if the opportunities offered by globalisation are to be exploited and the risks associated with globalisation minimised and managed.

The evidence is overwhelming that countries need good physical, social and institutional infrastructure to be able to engage successfully in international trade. And countries clearly need competitive products, which are, in turn, influenced by broader economic policies such as the country's exchange rate to make best use of trade opportunities. As noted by Nicholas Stern, Chief Economist of the World Bank:

> *If you have unreliable power supply, no financial depth, lots of harassment from government officials, a high level of corruption, and a very low skill base, then more open trade and investment policies, beneficial though they are likely to be, are unlikely to generate large increases in productive investment and employment.*[lxxii]

A similar conclusion is reached in a very recent study on globalisation by the Australian Department of Foreign Affairs and Trade:

> *Domestic policy settings are central to whether economies capture the gains from freer trade and investment flows and whether the population as a whole gains equal access to these opportunities. To maximise globalisation's benefits for growth, government policies must deliver functioning markets, effective property rights, stable macroeconomic policy, effective and accountable regulatory settings and enforcement, and efficient social and physical infrastructure services. Governments also play an important role in promoting equity and ensuring disadvantaged groups are not left behind as incomes rise in globalising economies*[lxxiii]

The World Trade Organisation also notes the two way relationship between the quality of institutions and wider engagement with the international economy. They note for example:

> *Trade and foreign direct investment require that traders are confident, contracts will be enforced, payments will be made and property rights to tangible and intangible assets well defined. Countries with a better track record in such matters are therefore likely to trade more.*
>
> *On the other hand, openness may also have a positive effect on the quality of institutions. Lower trade barriers may, for example, increase the incentives for individuals and governments to improve the formal and informal rules governing commercial interactions in order to induce more trade. Trade in itself can increase the knowledge and understanding of foreign institutions and potentially lead to institutional reform.*
>
> *Empirical research confirms two – way causality, with institutional quality having a positive effect on openness and openness having a positive impact on institutional quality.*[lxxiv]

Furthermore, the report notes:

> *The level of corruption is another indicator of institutional quality. Empirical support exists for a link between higher perceived corruption and lower investment and growth, and openness seems to be negatively correlated with corruption. More open economies exercise stricter control over corruption than less open ones. Again, it is not clear a priori whether trade leads to less corruption or less corruption induces more trade. It has been argued, however, that in markets with low levels of competition economic rents are higher and illicit payments may therefore also be higher. To the extent that greater openness engenders competition, then, corruption levels may be expected to fall.* [lxxv][lxxvi]

Not only are the benefits of trade not automatic, or easy. There are social, economic, and political costs. There are winners and losers. And adjustment costs. As the World Trade Organisation notes:

> *The adjustment of an economy to the …opportunities is not necessarily immediate and often involves costs. In*

> *an economy with an inflexible labour market, for instance, job losses in import competing sectors may not be immediately compensated by job creation in expanding exporting sectors. The resulting temporary increase in employment represents an economic cost. If financial markets are not efficient companies with lucrative opportunities in foreign markets may not be able to find the funding necessary to expand their activities. Again, capital and workers may be idle for some time that is costly for the economy.*
>
> *The quality and availability of infrastructure and utilities also have an important effect on the adjustment process following trade liberalisation. These amenities for instance influence the quality of information flows within a country and information is crucial for firms and workers to react to trade reform. They also affect the size of investments companies need to make in order to expand their activities. The higher those investments, the more likely it is that adjustment takes time, in particular in countries characterised by inefficient credit markets.* [lxxvii]

The key point here, however, is that many of these factors are themselves directly amenable to policy and public investment decisions of the developing country government itself. It can, through policy and its budget priorities, shape important parts of the landscape in which adjustment occurs.

Trade barriers and trade distortions also restrict the potential benefits from globalisation.

Developed countries often urge developing countries to adopt liberal, deregulated, and market oriented economic regimes as pathway to growth. Yet some of the most vocal developed countries are the same ones that adopt protectionist and interventionist policies that substantively restrict and damage developing country export prospects.

As noted by the World Bank average tariff rates in rich countries are low but they maintain barriers in exactly the areas where developing countries have comparative advantage: agriculture and labour intensive manufactures. This can occur through tariff peaks (ie high tariffs – some as high as 500 per cent – on certain products of interest to developing countries) and tariff escalation (tariff rates that rise as the degree of processing – and profit – goes up). The World Bank's latest review of the global economy concludes that "border protection in rich countries continues to be high, non transparent, and anti development".[lxxviii]

Tariffs are therefore quite likely to be aimed at – and hit - products of interest to developing countries more so than the products of developed countries. The result is that Mongolia, for example, pays nearly the same dollar amount in tariffs to the US government as Norway, even though it sells only three per cent of what Norway sells to the US.

Barriers amongst developing countries also important

But barriers between developing countries are also important, and often higher than those in developed countries. East Asian exporters face tariffs in other East Asian countries that are 60 per cent higher than in rich countries.

Noted trade economist Jagdish Bhagwati argues it is a misconception that the world trading system is 'unfair' or that poor countries face protectionism that is more acute than their own. He argues industrial country tariffs average 3 per cent, while poor countries' tariffs average 13 per cent. He also notes that "the new users of anti dumping actions - among them Argentina, Brazil, India, South Korea, South Africa and Mexico, are now filing more anti dumping complaints than the rich countries". [lxxix]

Other trade distortions that constrain development

Trade barriers at the border are not the only factors that inhibit the ability of developing countries to engage in international trade and get the best returns from their own domestic resources. Other factors apply as well, including domestic subsidies within developed countries, price support schemes, and export subsidies that depress world markets for products of interest to developing countries and increase the price volatility of the products concerned.

Such practices have a particularly adverse effect on development and poverty in developing countries when they apply to agricultural products. That is because latest estimates[lxxx] show agriculture is still the largest employer in low income countries, accounting for about 60 per cent of the labour force, and producing about 25 per cent of GDP. And almost three quarters of the poor in developing countries live in rural areas.

The case of sugar – adverse implications on development

Sugar is just one example of where developed country agricultural support programs have adverse development impacts. As noted by the World Bank, "EU farmers are paid three times the world price for sugar, and EU taxpayers and consumers then foot the bill for dumping the resulting surplus – seven million tons of it – on world markets. Non subsidising exporters such as Malawi and Thailand suffer the twin consequences of lower prices and lost market shares. Meanwhile, high tariffs keep the EU's own market firmly out of bounds".[lxxxi]

And even notionally pro – development schemes like tariff preferences for developing countries on sugar can have substantial and adverse development consequences for developing countries. To begin with, the EU preferences on sugar only apply to ex colonies, and are therefore at the expense of other developing countries (and efficient exporters like Australia). In other words, preferences can *divert* trade from other developing countries rather than *expand* trade from developing countries[lxxxii].

Furthermore, because preferences tend to be granted to ex colonies in Africa – rather than the bigger concentrations of poor in Asia – their overall developmental impact is limited and poorly targeted. As noted by the World Bank, just four countries – India, Bangladesh, China and Indonesia – account for three quarters of the world's rural poor. "It is in Asia, therefore, that rural income growth will have the greatest impact on rural poverty".[lxxxiii] The Bank goes on to conclude:

> *Most of the poor (of the world) live not in least developed countries, which get deep trade preferences, but in Asia, which gets fewer preferences, if any. Thus deep preferences do not reach the majority of the world's poor living on less than $US1 per day*.[lxxxiv]

Significantly, even those that receive the trade preferences on sugar can have their longer term development prospects threatened. Take the case of Fiji. An important recent study[lxxxv] by ABARE notes that as a result of sugar preferences from the EU, Fiji receives between two to three times the world market price for sugar. The subsidy element alone to the Fiji sugar industry is around three per cent of Fiji's GDP and the high export prices paid to Fiji have helped to make sugar the second largest Fijian export after garments.

Understandably, these arrangements and scale of payments have "significantly affected resource allocation across sectors, and the pattern of economic growth in Fiji has been profoundly affected". Amongst other things, sugar cane has expanded to marginal lands where average costs exceed the world market price.

But the study shows that the future for the sugar industry in Fiji looks bleak, partly because of internal Fiji land complexities, but also due to the uncertainties as to how long the EU preference margin will continue. The uncertainty arising from both factors has resulted in minimal investment and declining productivity. The industry itself is in decline. Actual output of sugar is now almost half the level it was in the mid 1990s. This has significant social and developmental implications because sugar is by far the most important source of cash incomes for rural Fijians. The study shows that the adjustment costs for providing alternative and viable employment in large areas of land hitherto used for sugar are both high and long term.

In brief, the existence of substantial trade preferences that paid up to three times the world market price for sugar attracted large resources into the industry. But the likely withdrawal of the preferences then leaves a large industry marooned and uncompetitive with consequent social, economic, and development implications for rural Fiji.

Cotton – the latest example of how domestic trade policy can have adverse developmental implications

Developed country protection of farming interests can also adversely affect agricultural crops like cotton. The essence of this particular and high profile recent case is that United States' financial support for its domestic cotton producers has adversely affected the development prospects of efficient, but poor, West African cotton producers and exporters. For example:

> *'From 1998 to 2001, when world cotton prices were falling, high cost exporters such as the US should have lost markets, and low cost African producers gained. Because of subsidies, the opposite happened: US cotton exports doubled. Oxfam calculates that in 2001 –2 Africa lost $US 301 million as a result of US cotton subsidies. Benin lost 9 % of its export earnings – more than wiping out the benefit it received from western debt relief ".* [lxxxvi]

And this from the World Bank Institute:

> *Fewer than 10 per cent of America's (cotton) producers would be competitive on world markets without support. But in 2001/2 the subsidy provided to American cotton farmers exceeded the total national income of cotton producing countries like Burkina Faso and Mali. In a bizarre throwback to the principles of Bolshevik state planning, it also exceeds the value of cotton output. In cotton as in other areas of agricultural trade, market outcomes owe less to comparative advantage than to comparative access to subsidies.* [lxxxvii]

The significance and role of aid funding in the process of globalisation

Relative significance of aid compared to broader trade, financial, and economic flows.

The preceding sections argue that integrating with the world economy through trade and international capital flows is a sound – but by no means automatic or necessarily easy - strategy for developing countries seeking to grow.

What then, is the role of aid in an increasingly globalising world?

A good starting point is to put aid in perspective. Compared to broader trade and financial flows, aid flows are very small. There is extensive evidence for this. To cite just a few of the more obvious examples:

- Each year industrialised countries provide over $US300 billion in support to their own agricultural producers – roughly six times the amount they spend on aid and more than the total income of the 1.2 billion people in the world living on less than $US 1 per day.[lxxxviii]

- Protection in rich countries costs developing countries more than $US 100 billion per year, twice the total volume of aid from developed to developing countries. [lxxxix]

- OECD agricultural subsidies in dollar terms are two thirds of Africa's total GDP. Abolishing these subsidies could return three times all the ODA put together to developing countries. Kofi Annan wants $10 billion to fight HIV/AIDS; that is just 12 days subsidies.[xc]

- Rich countries pay out $1 billion a day to their farmers in agricultural subsidies; that is more than four times all development assistance going to poor nations.[xci]

- The average cow in Japan attracts a subsidy of $ US 7 per day. But ¾ of people in sub Saharan Africa live on less than $ US 1 day.

- EU Governments spend enough money on the Common Agricultural Policy every year to fly all their 21 million dairy cows around the world – stopping off in London, Shanghai, Hong Kong, Singapore, Hanoi, Siem Reap, Brisbane, Auckland, Rarotonga, Los Angeles and San Francisco – and still be able to give them over 400 pounds spending money each. [xcii]

- According to the former Director General of the WTO, a successful outcome to the current Doha Development Round of trade negotiations "would grow the world economy by $US 2.8 trillion – and that would be like adding another China to the global market place. This would lift more than 320 million people out of extreme poverty within 10 years"[xciii]

- Annual cotton subsidies to US farmers of more than $3 billion (three times US foreign aid to Africa) depress world cotton prices and crowd out poor but efficient farmers in West Africa.[xciv]

- The value of world wide aid is around $US 50 billion per year, compared to foreign direct investment into developing countries of around $ US 200 billion[xcv] and the value of exports from developing countries around $ US 2 trillion.

Aid is therefore dwarfed by the larger trade and financial flows that are characteristic of globalisation.

And aid volumes are usually very small both when compared to the economies of both the providing, and receiving country. Australian aid, for example, represents about one per cent of total Government expenditure.

And total aid flows are small when viewed through the eyes of an individual developing country. Indonesia receives just $US 7 per person per year from the aid it receives from all around the world. And total aid to Indonesia represents just over one per cent of its total economy. China receives the equivalent of $US 1 foreign aid per person per year and total aid flows to China represent around one tenth of one per cent of China's economy.

Even in the case of smaller populations and economies of the Pacific, aid needs to be seen in context: total aid to Papua New Guinea from around the world is the equivalent of just $US 39 per person and represents just 7.2 per cent of the PNG economy[xcvi].

But the relevance and effectiveness of aid cannot be judged just by its size. That is because well designed aid programs are much more than simply resource transfers and flows of money. Successful aid is much more about equipping developing countries with the technical, policy, institutional and managerial capacity to solve their own problems and pursue reform. Successful aid is about reform and providing the catalyst for the transformation of institutions in developing countries. Successful aid provides ideas, policy insights, support for policy reform, capacity building and the like that the private sector has no commercial incentive to provide and the public sector in the developing country lacks the capacity to do by itself.

There is a wealth of material on how and under what circumstances aid programs have contributed to the broader development process. And while the overall record of aid is understandably mixed (and generally has more to do with the level of commitment at the developing country level rather than aid per se) it is evident that aid is increasingly being called upon to address newer and even more complex challenges.

The situation is summarised well by the World Bank in its landmark study *Assessing Aid: What Works, What Doesn't and Why.* Amongst other things the study concludes:

> *Foreign aid in different times and different places has … been highly effective, totally ineffective, and everything in between. Perhaps that is to be expected in a complex endeavour that has spanned half a century with scores of countries as donors, a hundred countries as recipients, tens of thousands of specific activities and nearly $US 1 trillion in finance. But hindsight is valuable only if it produces insight. The checkered history of assistance has already led to improvements in foreign aid, and there is scope for further reform. The pressing question: How can development assistance be most effective in reducing global poverty ?*
>
> *The answer is needed urgently. While there has been more progress with poverty reduction in the past 50 years than in any comparable period in human history, poverty remains a dire global problem. More than a billion people live in extreme poverty – on less than $US 1 a day. Even more lack basic services that people in developed countries take for granted: clean water, sanitation, electricity, schooling. It is ironic – and tragic – that just as economic reform has created the best environment in decades for effective assistance, donors have cut aid back sharply. In 1997 OECD donors gave the smallest share of their GNPs in aid since comparable statistics began in the 1950s – less than one quarter of one per cent. It would take roughly a 50 per cent increase even to restore aid to its 1991 level*.[xcvii]

Aid, therefore, faces several challenges. And new challenges have arisen. Aid is being called upon to support reform not just in the traditional sectors of education, health, agriculture, and environment but in newer and more complex areas such as public sector reform, policing, judicial reform, people trafficking, money laundering, and anti terrorism.

While each of these issues has some direct and indirect links to globalisation, the role of aid in each of these particular sectors is beyond the scope of this paper. Instead, this final section of the paper surveys how aid programs support developing countries to maximise the advantages - and minimise the risks - of increased economic integration with the global economy, particularly in the areas of trade and finance.

Direct response to the pressures arising from globalisation

The Asia financial crisis of the late 1990s showed starkly that globalisation carries with it real economic, social and political risks for countries.

The Australian Government, through AusAID, responded in a number of ways. In Indonesia, for example, Australia took a number of decisions to help manage the immediate social impacts of the crisis. This included a commitment of around $ 33 million in food aid commodities; provision of emergency medical supplies valued at over $10 million; support for two major extensions of the UNICEF supplementary feeding program ($3.9 million) and support for the Indonesian Government's "back to school campaign". Similar interventions occurred with respect to other countries in the region including the Philippines, Thailand, Vietnam and Laos

The aid program was also used as the most appropriate vehicle for trying to address some of the root causes of the problem. For example, the Australian Government, through AusAID, established a mechanism through which Australian technical expertise could be provided to Indonesia on areas such as debt restructuring, bankruptcy and commercial law, foreign investment, capital market development and financial management. Australian assistance also helped the Government of Indonesia draft a new anti money laundering law which, in turn, facilitated Indonesian access to a $US 350 million Asian Development Bank Finance Sector Support Loan. A package of 60 additional tertiary scholarships were also provided through AusAID to enable Indonesians to study economics and finance in Australia. Again, similar interventions were also put in place with other countries in the region.

The economic and financial interlinkages that had contributed to the speed of the crisis also called for a regional response. This occurred. Amongst other things, for example, the Australian Government through AusAID financed an Asia Crisis Fund (later termed the Asia Recovery and Reform Fund) that focused on economic governance, financial sector reform, and policy responses to the social aspects of the crisis for the region. AusAID commissioned expert studies on the impact of the crisis on the environment, and on children, in Asia helped inform policy responses and lead to the establishment of the Social Protection Facility for East Asia.

Improved capacity for engaging in international trade:

A growing number of developing countries have concluded that it is in their own national interests to be an active and full participant in the international architecture governing trade liberalisation – usually in the form of membership of the World Trade Organisation (WTO).

Membership of the WTO certainly imposes costs and constraints on countries. Rodrik, for example, says "that it has been estimated that it costs a typical developing country $US 150 million to implement requirements under just three of the WTO agreements: customs valuation, sanitary and phytosanitary measures and intellectual property rights…a sum equal to a year's development budget for many of the least developed countries"[xcviii].

But, on the evidence, more developing countries than not judge that the net benefits of WTO membership are worth it. WTO membership has now reached 148 countries of which the majority are developing countries. Some 25 countries are now actively seeking accession to the WTO, all of which are developing countries or from the former Soviet Union. Countries in our region such as Laos, Vietnam, Tonga, Samoa and Vanuatu are actively seeking accession to the WTO.

Why do developing countries see it in their national interests to join the WTO? Improved, and predictable, market access is one such benefit. (Agreements on improved market access that are thrashed out between the major economic powers in the world are "multilateralised" and passed through to all members of the WTO – even the smallest). And a multilateral, rules based system that has independent adjudication and compensation payable for rule breaking – even by the biggest economic powers in the world – has given small developing countries more protection and rights than they would be able to achieve through one on one bilateral negotiations with an economic superpower.

Australia supports the efforts of developing countries to engage successfully in the international architecture of trade policy, trade liberalisation, and trade relations. More specifically, AusAID expects to provide some $A 31 million worth of technical assistance and capacity building for some 78 trade related activities this financial year. The range of activities being supported is very broad but includes:

- Training on the multilateral rules for intellectual property rights and copyright in Indonesia

- Strengthening food safety regulations and quality assurance for fish and food products destined for export markets in ASEAN countries

- Helping to prepare Vietnam's financial services sector for international integration

- Strengthening plant and animal quarantine inspection capacity and policies in several countries including East Timor, PNG and Samoa

- Several activities designed to strengthen the effectiveness, efficiency, and transparency of customs policies and institutions in countries such as Indonesia, and the South Pacific.

- Technical assistance to reduce barriers to regional investment in Indonesia

- Technical assistance to improve taxation compliance by large corporate taxpayers in Indonesia

- Assistance to review tariff levels in PNG

- Financial support for trade officials from Lao PDR, Cambodia and Vietnam to participate in the WTO Trade Law course.

Australian support for China's accession to the WTO – trade implications but also deeper policy reforms.

An interesting case study of how a relatively small level of aid support can have very large economic and development consequences is found in Australia's aid support for China's efforts to join the WTO.

In essence, Australian aid support enabled over 1700 Chinese officials to undertake training and capacity building in a range of trade policy issues that were central to China's full participation in the WTO. The training ranged from workshops through to acquiring Graduate Diplomas in Economics and Commerce from the University of Adelaide. Australian Government support through AusAID for this activity totalled $A 7.6 million over nine years. And while this activity was only one small part of a much larger effort by the Government of China to join the WTO it was a critical component. China itself did not have the experience or skills of multilateral trade policy to prepare itself in time for accession to the WTO. Australian aid was able to build up a critical mass of key officials in China responsible for trade and broader economic reform, and help shape the way they think about and resolve international economic issues.

What are the economic and developmental benefits that occur as a result of China being a member of the WTO?

First, membership of the WTO gives China direct and equal access to the trade liberalisation and market access provisions enjoyed by all other members of the WTO. Furthermore, membership of the WTO means that China cannot be discriminated against in terms of market access or trade decisions. And it will have access to multilaterally agreed rules and dispute settlement provisions.

China can therefore now engage in a framework of international economic and trade relations which is liberal, rules based, non discriminatory and predictable. This provides a secure platform for further engagement and integration with the world economy. The World Bank cites studies[xcix] that put the global welfare gains of China's accession to the WTO at $US 74 billion per year, of which around $US40 billion accrues to China. Some estimates suggest that WTO membership will add one to two percentage points of annual growth to China's GDP over the longer term.

This is important for a country which still has an average per capita income of just $US 4390 per head[c] (compared to $US 26,960 per head in Australia) and where 161 million people still live below the $US 1 day consumption measure[ci].

A second broad benefit of China's membership of the WTO is what it means for other countries – including other developing countries. China imported more than $ US 1 trillion in the five years to 2002. It is now importing at a rate of $US 31 billion per month. At such a rate, China will import $US 1 trillion over the coming three years, and by 2010 will have the ability to import $US 1 trillion every two years. China predicts its economy will quadruple between 2000 and 2020[cii]. This provides significant economic and commercial opportunities for developing countries to export to China and under an architecture for imports that is more open, more liberal, more transparent and more predictable than would have been the case had China not joined the WTO.

The third – and perhaps most important and far reaching – benefit to development will be that membership of the WTO requires, and then "locks in" a good deal of institutional and policy reform deep inside China's economic structures. Joining the WTO does not just affect enterprises directly involved in trade. Many of the institutions and policies that sit well behind – but ultimately affect – the operations of actual trading enterprises are required to also come into conformity with multilateral rules when WTO accession occurs. This can include a range of changes to national policies, including those with respect to such large and important economic activities as overall government procurement; agricultural subsidies; copyright, patents and respect for intellectual property; and currency and banking.

There are several examples of the breadth and depth of economic and policy reform required as a result of China's accession to the WTO. As noted by the leader of the Australian delegation[ciii] involved in negotiating China's accession to the WTO, these included:

- more predictable changes in economic and regulatory behaviour
- uniform administration of policy across China (by itself a key characteristic of nation building and more rational economic policy)
- internationalisation of product standards
- binding commitment to rules, market access and adjudicated settlement of disputes

- More than 50 old laws, 1000 plus old regulations repealed or changed, and 1226 judicial rulings amended.

China's accession to a multilateral institution that promotes, requires, and locks in liberal economic policies and rules based settlement of disputes is a historic event. As noted by the President of the US China Business Council in his testimony to Congress earlier this year:

> *The Chinese government continues to move away from the remnants of the Stalinist planned economy, often against entrenched bureaucratic vested interests…..An important trend …is the reduction of the stultifying and corruption ridden but all pervasive system of bureaucratic approvals and licensing, in favour of a more equitable system that places fewer obstacles in the path of productive economic activity – for Chinese and non – Chinese alike*

An economically prosperous and politically stable China is clearly in the long term economic and strategic interests of all countries, including – or perhaps especially – developing countries.

The process of reform associated with China's accession to the WTO is far from over. And it is certainly not easy or without its own costs. Agricultural restructuring in China as part of WTO obligations involves real social, economic and political challenges for China. But the Australian Government, through AusAID, intends to continue to provide technical assistance and capacity building to help China manage the next stage of reforms.

Support "behind the borders" – physical, social, and institutional infrastructure

Helping build the capacities of developing countries to engage in trade negotiations and develop sound trade policy is important. But by itself it is clearly not enough. For countries to take advantage of globalisation they need to have the physical, social and institutional infrastructure to enable them to make best use of their resources.

The contribution that good physical infrastructure makes to efficient and effective engagement with a wider global economy is intuitively obvious. Countries need good roads, ports, electricity and telecommunications to be able to export and import in a competitive and cost effective manner. The significance of this has been put into perspective by a recent World Bank study which noted, amongst other things, that:

> *The costs of transporting developing country exports to foreign markets are a much greater hindrance to trade than are*

tariffs….A study shows that for 168 out of 216 US trading partners, transport cost barriers outweigh tariff barriers. For the majority of Sub – Saharan African countries, the tariff incidence was relatively insignificant at less than 2 per cent, while their transport cost incidence exceeded 10 per cent. A doubling of shipping costs is associated with slowdowns in annual growth equivalent to more than one half of a percentage point[civ]

Australia, through its aid program, has demonstrably contributed to the building up of priority physical infrastructure that can, in turn, open greater economic opportunities for poor people. The My Thuan Bridge in Vietnam is just one example. Designed and constructed under the aid program using Australian expertise and contractors, this large bridge now allows 60,000 vehicles a day to cross the Mekong: more than double the previous capacity by ferry and with reduced air pollution and noise from queuing. Three new industrial zones have been established near the bridge. An estimated 16 million people in the Mekong Delta region, mainly farmers, benefit as a result of reduced time and access costs to markets and services.

Similar examples occur in the Pacific. In PNG, for example, Australia has supported the maintenance of the Highlands Highway. This highway, linking the highlands area with Lae on the coast, is PNG's economic artery. It serves some 1.8 million hectares and 40% of PNG's population. It is the single most important highway in PNG in terms of trade volume and value. Some 65% of all imports into PNG and all the coffee exports (PNG's most valuable agricultural export) are carried on the Highland Highway. Severe economic and financial constraints, compounded by institutional issues resulted in lack of maintenance. The highway was almost impassable.

But the Australian funded aid support has halved the transport turn around time between Goroka and Lae from four days to two. Prior to the maintenance there were long stretches of road where trucks could not travel faster than five kms per hour. Now they average 50 km an hour. Restoration of this economic artery has allowed public transport operators to use the highway again thus reducing fares and allowing produce to get to markets.

Agriculture

Australian aid, through both AusAID and ACIAR, has demonstrably contributed to improving agricultural productivity in the Asia Pacific region. This, in turn, has expanded trade, income, and employment opportunities for poor people in the region.

As just one example, the Philippines was plagued by a major epidemic outbreak of foot and mouth disease in 1995. There were more than

1500 outbreaks affecting 100,000 animals in 22 provinces. Exports of cattle from the affected regions stopped. Through Australian assistance, and in cooperation with the FAO, more than two thirds of the Philippines and half the national animal population, has been declared free of foot and mouth disease. Only two regions remain affected by the disease and work is continuing to eradicate it[cv].

Similar interventions against foot and mouth have also occurred in Thailand, Laos and China.

And in Papua New Guinea, control of the banana skipper butterfly through Australian aid rescued that country's banana industry and prevented the pest reaching the Australian mainland (with benefits then estimated at $200 million)

In each case the point is clear. The countries concerned did not have the technical or logisitical capacity at the time to respond to a real problem that was adversely affecting exports, income and employment. Development assistance was the one thing that ultimately made the difference. This was not only a critical benefit for the countries concerned. As often happens with aid programs the developmental benefits accruing to developing countries were also very much in Australia's own national interests. Eradication of agricultural diseases and pests in our region through bilateral and multilateral aid serves our own national interests equally as well as it contributes to development.

Social infrastructure – building productive capacity through education and health

Economies in our region cannot develop and engage in the broader global economy without sound education. As noted by Nicholas Stern, Vice President of the World Bank:

> "*Education takes centre stage in any discussion of development strategy for two reasons. First the quantity and quality of education strongly influence the labour force, governance and the workings of most institutions. Education is thus a key determinant of the investment climate. Second, universal access to basic education is essential for ensuring that all segments of society benefit from macroeconomic growth'*[cvi]

Australia, through its aid program, has trained almost 45,000 primary and high school teachers in developing countries in our region. The Australian aid program has built or refurbished at least 1200 schools and education centres. Australian assistance has gone towards providing over 50,000 people with vocational training. Australian Development Scholarships enable people from developing countries to build up technical and management skills through study at Australian tertiary institutions and then return to their countries to contribute.

In the last eight years, over 3000 students have completed various business and public sector management degrees.[cvii]

Australian aid also directly contributes to improved health in developing countries. Since 1999 Australian aid trained 1900 health professionals; built or refurbished over 700 hospitals and health clinics and provided over 600 000 water supply and sanitation units. Child mortality in Nepal has been reduced by 22 per cent in four years as a result of the National Vitamin A program supported by Australian aid – helping to avert some 35,000 child deaths per year[cviii].

And the Women and Children's Health Project in PNG has directly resulted in the vaccine cold chain now reaching over 90 per cent of the country (compared to only 50 % in 1998). Over 1400 PNG staff have been trained in various aspects of primary health care affecting women and children. These are clearly basic building blocks for a public health system in a country where the child mortality rate – at 77 per 1000 live births – is one of the worst in the region.

In October 2000 the World Health Organisation declared the Western Pacific region (which includes nearby neighbours such as PNG) polio free. Given the scale and technical / managerial complexity of the problem this could not have been accomplished without bilateral and multilateral aid. Developing countries would have suffered the much larger social and economic costs of treating – rather than preventing – polio. And Australia would have been exposed to the disease.

But new challenges have emerged. One of the negatives of globalisation is that increased integration and speed of movement can help spread infectious and contagious diseases such as HIV/AIDS. In neighbouring PNG, for example, AIDS and related diseases are now the main cause of death in Port Moresby General Hospital. PNG has an estimated 15,000 – 22,000 people infected with HIV in PNG (compared to an estimated 12,000 HIV positive people in Australia, with five times the population of PNG). The number of HIV positive people in PNG is estimated to be increasing annually by 15 – 30 per cent annually.[cix]

This clearly has significant social, economic and developmental implications for a country such as PNG that already has around one fifth of its population living in poverty. Indeed, an AusAID funded research study on the economic impact of HIV / AIDS in PNG concluded that if HIV /AIDS in PNG follows a similar pattern of transmission as in Africa, then by 2020 PNG'S population could decline by five per cent; real GDP could decrease by 6 per cent; economic welfare fall by 10 per cent; and real tax revenue fall by sixteen per cent.[cx]

Australian aid has enabled some of the basic building blocks to be put in place to respond. For example, programs have been introduced to increase community awareness of the risks of HIV/ AIDS and the preventive measures that can be taken. A surveillance system has commenced which enables rational and targeted planning to cope with the spread of the disease; laboratories have been established and equipped; clinics specialising in sexually transmitted infections have been strengthened; and clinical management practices upgraded for Department of Health staff.

Institutional development, capacity building, policy engagement and governance

Policies, institutions, and the conduct of government affect development. Some cross national econometric studies suggest that the quality of a country's public institutions is a critical – and perhaps the most important – determinant of a country's long term development[cxi]. One study by the World Bank concluded that countries with quality institutions (defined in terms of the strength of the rule of law, quality of public bureaucracy, and the extent of corruption) and good economic policies (defined in terms of control of inflation, fiscal imbalance, and degree of openness of the economy) had real GDP per capita growth many times higher than those with weak institutions and poor policies[cxii].

The policy choices of governments, and the quality and responsiveness of institutions is therefore important because of the way that affects the broader development process. They are also important because they shape and affect the 'enabling environment' in which the private sector operates. This in turn directly affects the competitiveness of exports and import competing goods in a country, and its attractiveness as a host to foreign direct investment and other capital flows.

So, policies and institutions matter. Can aid programs assist in that process?

The links between the broad policy and institutional environment, and aid programs, are complex. Often the cause and effect relationships between aid support and policy reform cannot be directly seen. Indeed, for reasons of political and national 'ownership' of reform, some of the most effective aid interventions will deliberately take a low profile, or the reform process take years to emerge and take hold.

But tangible examples of how aid programs can act as a catalyst to promote good policies and institutions certainly exist. Uganda is an interesting case study in this regard for several reasons. First, as noted in a comprehensive review of economic reform in Africa : "Uganda's reform program has been one of the most successful in Sub Saharan Africa. The Gross Domestic Product grew by an average 6.4 per cent during 1987 – 96 and inflation has been reduced from more than 100 per cent in 1987 to single digit figures. The Government has achieved both stabilisation and substantial decontrol of the economy"[cxiii].

What also makes Uganda's experience so interesting is that it achieved remarkable and tangible success in economic growth – including a doubling of GDP over just eleven years - *despite* Uganda being land locked, low income

($320 per head in 2000) relatively isolated from markets and suffering from a post conflict situation. There are, in brief, some parallels here for countries in our region.

The third reason why Uganda is an interesting case study is that it involves a developing country initially seeking a growth path through a closed economy but then finding that this imposed unsustainable economic and social costs. More specifically, the Museveni Government assumed power in January 1986 after the previous disastrous economic policies of Amin. The economy had shrunk by more than 20 per cent from peak in 1970. Inflation was at 240 per cent. The Government debated what to do.

The Government chose to adopt a closed economy model "including price controls and ideas about barter trade with Libya, North Korea and similar countries. The 'Washington consensus' of liberal and open economic relations was regarded as an imperialistic policy package"[cxiv]. However this policy stance was soon recognised as "a serious mistake, as it fuelled macroeconomic instability and worsened external viability". Within a year it was clear that the exchange rate and inflation levels were out of control. A new program was needed.

The Government therefore took hard decisions including a 76 per cent devaluation of the currency and major currency reform. The overall package of reforms then led to a significant and sustainable turn around in Uganda's economy: inflation fell from around 190 per cent to 28 per cent by 1991, GDP grew at over 6 per cent per year over the period 1988 – 91, and there was a slow recovery of exports.

The fourth and final reason why this case study is so interesting is because of the light it sheds on the role of aid in prompting, promoting, and securing economic reform. Aid did many things during the reform period. Amongst other things, it provided needed foreign exchange for the weekly foreign exchange auctions. But aid involved much more than a transfer of financial resources. It involved a transfer of ideas and policy engagement at a critical time and in a critical manner. As the reviewers of this economic reform success story noted, Government officials in Uganda said aid played its most decisive role in shaping policy. More specifically:

> *When the Government reluctantly introduced market based reforms the policy dialogue, advisory services, training and technical assistance provided by donors were of critical importance both for the decisions to reform and for the direction of the reforms*"[cxv].

Furthermore

Technical assistance and especially foreign aid and the conditionality linked to it helped push the balance in favour of the reformers in government during this period of reluctance (1987 – 92)[cxvi]

Numerous examples demonstrate similar principles and levels of impact in our own region.

In Vietnam, for example, Australia supported the development and dissemination of the new Enterprise Law that sought to improve the legal framework for private enterprise operations. One measure of the impact of this Australian assistance is that within 18 months of the introduction of the law 27,000 new business enterprises employing more than 500,000 people had registered. Such impact reflects the growing domestic confidence by Vietnamese in the private sector environment. But it also demonstrates the catalytic role that small amounts of Australian assistance can provide, particularly where it helps shape policy and the broader environment under which development can take place.

Urban myths might suggest aid programs do not promote reform and development, especially in the South Pacific. They can and they do. For example an Australian aid program, in cooperation with the Asian Development Bank, helped the Samoan Treasury introduce performance based budgeting, liberalise the financial sector and create an enabling environment for private sector development. Major changes to the taxation base introduced progressively in the late 1990s have seen tariffs reduced from 60 to 20 per cent. And corporate tax rates have been reduced from 35 % to 29%.[cxvii]

In August this year a Senate Committee of Enquiry visited Samoa (income of $US 1490 per head compared to $US 19,900 in Australia). The Senate Committee asked the local Chamber of Commerce business people what their experience and priorities were in terms of aid and development. They replied that Australian aid support to reform of the public sector over the last few years in Samoa was exactly the sort of support required for private sector growth. They said there was now a robust and active consultation process between government and the Chamber of Commerce, and the clarity and confidence they now had in the government system gave confidence for private sector investments and increased business activity.

All of this suggests that even small, but well designed, aid interventions can be a critical element in the promotion of reform. As noted by the World Bank

"Development aid totalled about $US 54 billion in 2000; this was only one third as much as foreign direct investment in developing countries ($US 167 billion) which itself was only a small fraction of total investment (nearly $US 1.5 trillion). This underscores the point that when aid makes a major difference in the fight against

poverty it does so through demonstration effects or improvements in institutions, not simply through resource transfer'[cxviii]

Conclusion

This survey comes to six major conclusions about the interrelationship between globalisation, trade, development and aid.

First, while globalisation is not a new phenomenon, its pace is picking up as transportation, communication and other costs fall and countries take policy decisions to open their trade and capital markets more.

Second, all of the accumulated evidence points to increasing trade (exports as well as imports, goods as well as services and finance) being closely correlated with economic growth. There are good reasons for thinking that such trade contributes to growth. And growth is a precondition for development and poverty reduction. But the quality of that growth and development is dependent upon a number of factors, including the policy choices made by governments. Opening an economy to trade without appropriate and sufficient regulation leads to the "wild East" experience of Russia described by Stiglitz. But supporting increased trade opportunities with good policies – for example that encourage labour intensive employment of semi skilled and or poor people - can be a powerful antidote to poverty, as China, Indonesia and Vietnam have all found.

Third, when governments make good policy choices about engaging in globalisation the results can be significant and strategically important. Both the pace and the scale of recent achievements in reducing poverty have been unprecedented. As Nicholas Stern, Chief Economist of the World Bank notes:

> *"The last twenty years have seen the first fall in total numbers living in poverty for two hundred years. Income per capita in developing countries is now rising faster than in developed countries. Between 1978 and 1995 200 million people were lifted out of absolute poverty in China. This involved a move from self sufficiency by province to engagement in global economy.*[cxix]

Fourth, while prudent engagement in the international economy offers the opportunity for significant and rapid growth, obtaining the benefits of globalisation is not easy. Nor is it automatic. There are internal and external barriers that a country must grapple with. There are costs and risks, winners and losers.

But of course there are also costs and risks, winners and losers in doing nothing, or turning away the international economy too. As Stiglitz says: "Globalisation is neither good nor bad"[cxx]. What and how governments get out of globalisation for their people depends critically upon the policy choices they themselves make and the quality of their institutions in implementing government policy.

Fifth, it follows that policies and institutions matter. As noted by Rodrik – somewhat a sceptic of globalisation :

> *No country has developed successfully by turning its back on international trade and long term capital flows. Very few countries have gown over long periods of time without experiencing an increase in the share of foreign trade in their national product………..*
>
> *But it is equally true that no country has developed simply by opening itself up to foreign trade and investment. The trick has been to combine the opportunities offered by world markets with a domestic investment and institution building strategy to stimulate the animal spirits of domestic entrepreneurs. Almost all the outstanding cases – East Asia, China, India since the early 1980s – involve partial and gradual opening up to imports and foreign investment*[cxxi]

Sixth, aid programs - although much smaller in volume terms than trade and financial flows – can be the critical catalyst that helps developing countries engage productively in globalisation and trade opportunities. They can do this through several paths. Aid can help countries engage in the international architecture of trade. And it can help them develop various 'behind the border" characteristics – including good physical and social infrastructure – that help make poor people more productive, more employed, and with higher financial and human capital. Importantly, aid can also help developing countries improve policies and strengthen the quality of their institutions.

Aid that supports countries reform their own policies and institutions can thus have a disproportionate – albeit often hidden – impact as reforms take hold and permeate the social and economic environment of the country.

Aid can therefore help developing countries engage productively and purposefully in the international economy and through that increase their own prospects for growth and development. Turning their back on the international economy is simply not an option for sustained growth – no country has ever achieved it.

Growth and development through a productive engagement in the international economy is therefore in the national interests of developing countries, many of which are in our own region. And the economic, social, political, strategic and security benefits that accrue through good development spill over beyond national borders so that others benefit as well. As John Stuart Mill noted:

> *The great extent and rapid increase in international trade, in being the principal guarantee of the peace of the world, is the great permanent security for the uninterrupted progress of the ideas, the institutions and the character of the human race* [cxxii]

And a stable, economically prosperous region is demonstrably in Australia's national interest as well. Aid, although small, can continue to play a catalytic role in that endeavour.

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[i] A World Without Walls: Freedom, Development, Free Trade and Global Governance. Mike Moore. Cambridge University Press. 2003 page 15.
[ii] ibid page 16.
[iii] Nicholas Stern, Chief Economist for the World Bank defines globalisation as "growing economic integration among nations, reflected in larger flows of trade, services foreign investment, people and information". See A Strategy for Development. N Stern. World Bank Publication. World Bank. 2002. Page 53.
[iv] Anne Krueger, First Managing Director of the IMF, defines globalisation as "increasingly close international integration of markets for goods, services and factors of production: labour and capital".
[v] According to the OECD "globalisation is a multi faceted process that describes economic and social forces that have produced rapid growth in world trade, even faster integration of the world's financial markets, and the spread of international production networks". The Development Dimensions of Trade. OECD, Paris, 2002, page 20
[vi] More recently, "globalisation" has been applied to issues ostensibly outside of economics including, for example, the spread of HIV/AIDS, TB, and SARS; the spread of environmental stresses globally; right through to global interlinkages involving political stability, national security and counter – terrorism. While these broader issues are outside the scope of this paper, it is clear that there are substantial direct and indirect links between economic globalisation and development – the focus of this paper – and such issues
[vii] Indeed, some authors and commentators seem to compete amongst themselves to see how far they can go back in history to identify the first clear signs of globalisation. By broadening the definition of globalisation beyond the economic sphere, this enables authors like Keohane and Nye to discuss the spread

of early man out of Africa 1.25 million years ago, and note the spread of smallpox from 1350 BC in Egypt to China in 49 AD, Europe after 700, Americas in 1520 and Australia in 1789. Or that 'military globalisation' dates from at least the time of Alexander the Great 2300 years ago. See Governance in a Globalising World by Nye and Donahue. Brookings Institution Press. 2000. page 3 – 4.

[viii] Globalisation, Growth and Poverty – Building an Inclusive World Economy . World Bank publication. 2001. page 24.

[ix] A World Without Walls – Freedom, Development, Free Trade and Global Governance. op cit page 27.

[x] The Development Dimensions of Trade. op cit. page 22.

[xi] *Mainstreaming trade for poverty alleviation – a Cambodian experience* by Sok Siphana. Development Outreach. World Bank Institute. July 2003. page 7

[xii] *Made in China* Sydney Morning Herald 18 – 19 October 2003 page 29.

[xiii] Global Economic Prospects – Realising the Development Promise of the Doha Round. World Bank publication. Washington DC. September 2003. Page xix.

[xiv] Globalisation, Growth and Poverty – Building an Inclusive World Economy . op cit Page 5.

[xv] ibid.

[xvi] OECD Development Dimensions of Trade op cit. page 10. The figures refer to the trade weighted average of tariffs

[xvii] *Dismantling barriers and building safeguards: achieving prosperity in an age of globalisation.* Heinz Arndt Memorial Lecture. Address by Anne Krueger, First Deputy Managing Director, IMF, August 13 2003.

[xviii] Aid and Reform in Africa. World Bank publication. 2001 page 143.

[xix] A Strategy for Development Stern. Op cit, page 54.

[xx] Globalisation Growth and Poverty op cit page 37.

[xxi] ibid. page 37.

[xxii] Development Dimensions of Trade op cit

[xxiii] *Dismantling barriers and building safeguards: achieving prosperity in an age of globalisation.* Op cit.

[xxiv] Economic Development and Cultural Change 1992 pages 523 – 544.

[xxv] Economic reform and the process of global integration. Brookings Papers on Economic Activity No 1" 1 – 118.

[xxvi] The global governance of trade as if development really mattered. D Rodrik UNDP Background Paper October 2001 pages 23 and 24.

[xxvii] China : Twenty years of economic reform. Ross Garnaut and Ligang Song (editors) Asia Pacific Press 1999. page 9.

[xxviii] Attacking Poverty: World Development Report 2000 / 01. World Bank OUP page 5.

[xxix] *Progress on and prospects for achieving the Millennium Development Goals in East Asia.* Statement by Jemal – ud – din Kassum, Vice President, World Bank, to the Fifth Asia Europe Finance Ministers' Meeting 5 – 6 July 2003, Bali, Indonesia.

[xxx] China : Twenty years of economic reform. op cit page 1.

[xxxi] *Dismantling barriers and building safeguards: achieving prosperity in an age of globalisation* (Anne Krueger) op cit

[xxxii] A World Without Walls – Freedom, Development, Free Trade and Global Governance. op cit page 25.

[xxxiii] ibid page 25.

[xxxiv] World Trade Report 2003 World Trade Organisation, Geneva, page 104.

[xxxv] ibid, page 208 and 155.

[xxxvi] Economic Reform and the Process of Global Integration op cit.

[xxxvii] A good summary of the latest research findings and debate on the issue is available at box 1.1 on page 37 of Globalisation Growth and Poverty *op cit* .

[xxxviii] Trade Policy Reform and Poverty Alleviation Bernard Hoekman et al. World Bank Development Research Group World Bank 2002.

[xxxix] World Trade Report 2003 op cit page 99

[xl] Global Economic Prospects 2004 op cit page 220.

[xli] *The role and effectiveness of development assistance* in A Case for Aid. World Bank publication. 2002. page 66.

[xlii] That is, imports had grown faster than 6 per cent per annum on average. Presentation by Robert Lawrence at *Leaders in Development: Managing Political and Economic Reform* course at the John F Kennedy School of Government, Harvard University, July 2003.
[xliii] World Trade Report *2003* op cit page 106 – 107.
[xliv] *The twin effects of globalisation* Daveri et al. World Bank Research Paper. September 2003.
[xlv] Development, Trade, and the WTO. Bernard Hoekman et al. Page xv.
[xlvi] *Trade, aid and results: can we make a difference ?* Address by Nicholas Stern, Chief Economist, World Bank, to the Annual Bank Conference on Development Economics. May 15, 2003. Nicholas Stern
[xlvii] *Trading for development – the poor's best hope* by Jagdish Bhagwati. The Economist. June 22 2002 pages 24 - 26
[xlviii] The Development Dimensions of Trade. OECD report. op cit.
[xlix] See for example Assessing Aid : What works, What doesn't and Why by David Dollar et al. World Bank Policy Research Report. Oxford University Press. 1998. Chapter One.
[l] Rodrik op cit page 21.
[li] Trade Policy Reform and Poverty Alleviation Bernard Hoekman et al. op cit. page 3
[lii] Statement by Mrs Anne Krueger, First Deputy Managing Director, IMF, to the Fifth World Trade Organisation Ministerial Meeting in Cancun, Mexico, 11 September 2003. Reference WTO document WT/ MIN (03) / ST / 20.
[liii] Globalisation and its Discontents. Joseph Stiglitz. 2003. page 153.
[liv] Impact of the Asia Crisis on Children – issues for social safety nets. Report sponsored by the Australian Government for APEC. AusAID publication. August 1999 page 20..
[lv] ibid page 25.
[lvi] Indonesia in Crisis – a macroeconomic update. World Bank July 1998. page 1.
[lvii] Impact of the Asia Crisis on Children – issues for social safety nets. op cit page v
[lviii] *ibid* page 21.
[lix] "Why we've failed to recover from economic crisis" Sri Pamoedjo Rahardjo, Executive Director, Centre for the Study of Administration and Management, Indonesia, article in *The Jakarta Post* 9 October 2003.
[lx] *Indonesia in crisis* op cit. page 3.1
[lxi] East Asian Economic Miracle. The World Bank. Washington DC
[lxii] World Bank Little Data Book 2003 page 174 and 110.
[lxiii] *Trade and Poverty – is there a connection ?* Alan Winters page 43. Paper prepared for World Trade Organisation. See also a similar more widely published paper entitled *Trade Policies for Poverty Alleviation* in Development, Trade and the WTO. Hoekman et al editors. World Bank publication 2002.
[lxiv] ibid page 43
[lxv] Globalisation, Growth and Poverty op cit page xviii.
[lxvi] ibid
[lxvii] *Globalisation, reform, and poverty reduction.* Nicholas Stern, Chief Economist, World Bank in A Strategy for Development. World Bank 2002 page 75. Stern goes on to note with respect to China "In China's case the rise in inequality had more to do with the establishment of market oriented incentives in a previously centrally planned economy than with China's opening to international markets".
[lxviii] ibid page 80.
[lxix] World Trade Review 2003 op cit page 112.
[lxx] Enclaves or Equity – the rural crisis and development choice in PNG. Michael Baxter. AusAID International Development Issues No 54. 2001. Page xi.
[lxxi] Globalisation, Growth and Poverty op cit page 10.
[lxxii] *Globalisation, reform, and poverty reduction.* Nicholas Stern, Chief Economist, World Bank in A Strategy for Development. World Bank 2002 page 75
[lxxiii] Globalisation: keeping the gains. Australian Department of Foreign Affairs and Trade. Canberra 2003. page 20.
[lxxiv] World Trade Report 2003 op cit page XV11.
[lxxv] Globalisation, Growth and Poverty op cit page 10.
[lxxvi] ibid page 96.
[lxxvii] World Trade Report 2003 op cit page 99 – 100.
[lxxviii] Global Economic Prospects – realising the development promise of the Doha round op cit page 104.

[lxxix] *Trading for Development – the poor's best hope* by Jagdish Bhagwati. The Economist June 22 2002 pages 24 – 26.
[lxxx] Global Economic Prospects – realising the development promise of the Doha round. op cit page 103.
[lxxxi] *Farm Fallacies that hurt the poor* by K Watkins in Development Outreach. World Bank. page 10.
[lxxxii] Latest Bank analysis reveals other consequences of tariff preferences that are less than satisfactory from a development perspective. For example, the Bank finds that only a relatively small number of mostly middle income countries are the main beneficiaries of preference programs. In 2001 10 of the 130 eligible countries accounted for 77 per cent of US none oil imports under GSP provisions. Furthermore, the Bank finds that "most of the poor live not in the least developed countries, which get deep preferences, but in Asia, which gets fewer preferences. Thus deep preferences do not reach the majority of the world's poor living on less than $1 a day.

[lxxxiii] Global Economic Prospects op cit. Page 105.
[lxxxiv] ibid Page 135.
[lxxxv] Ending of EU sugar trade preferences – potential consequences for Fiji. Australian Bureau of Agriculture and Resource Economics (ABARE). ABARE current issues: 03.02. September 2003.
[lxxxvi] *Trade.* The Guardian and Action Aid 8 September 2003. page 25.
[lxxxvii] *Farm fallacies that hurt the poor.* Op cit Page 12
[lxxxviii] ibid page 10
[lxxxix] ibid page 9
[xc] *Contributions of the Doha Development agenda to development.* Speech by Mr Mike Moore, Director General of WTO, Geneva 25 June 2002. .
[xci] *Challenges of the Doha Development Agenda for Latin American and Caribbean countries* Address by Mr Mike Moore, Director General of WTO, 27 February 2002. This, and the following address, is available from WTO website / wto news/ speeches.
[xcii] Dumping on the Poor: The Common Agricultural Policy, the WTO and International Development. Catholic Action for Overseas Development. London. 2002
[xciii] "Disappointment, perhaps, but Cancun can deliver" by Mike Moore. *Australian Financial Review* Friday 5 September 2003 page 75.
[xciv] World Bank News release no 2004/055/ S September 3 2003. page 2
[xcv] Although much of the direct foreign investment goes to just a handful of developing countries, such as China. Sub Saharan Africa receives little foreign direct investment. Latest figures are available on the UNCTAD web site.
[xcvi] All figures quoted come from World Development Report 2004 – Making services work for poor people. World Bank. Washington. September 2003. Table 5 page 260.
[xcvii] Assessing Aid op cit page 2.
[xcviii] Rodrik The global governance of trade as if development mattered op cit page 26. The original estimate that Rodrik cites can be found in "*Implementation of Uruguay Round Commitments: The Development Challenge*" by Philip Schuler and J Michael Finger. World Bank Working Paper Number 2215. 1 October 1999.
[xcix] *China and the WTO: policy reform and poverty reduction* by Will Martin in Development Outreach. op cit
[c] World Development Report 2004 Table One. Page 252. This is on a purchasing power parity basis which takes into account the effect of exchange rates and gives a truer picture of the situation. However if the unadjusted approach is used then China has a Gross National Income per capita of just $US 940 per capita, compared to Australia of $US 19,740.
[ci] China – Country Economic Memorandum. World Bank. Page 9.
[cii] All figures cited in this paragraph are from the statement by the leader of the Chinese Delegation to the World Trade Ministerial Conference at Cancun, Mexico, H. E. Mr Lu Fuyan, Minister of Commerce. Reference WT/MIN (03)/ST/ 12 of 11 September 2003.
[ciii] Mr Graeme Thomson, Principal of Graeme Thomson and Associates, International Trade and Government Relations Consultants, in a presentation to AusAID and elsewhere.
[civ] Global Economic Prospects op cit page 181.
[cv] Australian Aid – Investing in Growth, Stability and Prosperity. AusAID. September 2002. Page 37.

[cvi] "*Investing in Education and Institutions*" in A Strategy for Development by Nicholas Stern. World Bank 2002. Page 93.
[cvii] Australian Aid – Investing in Growth, Stability and Prosperity op cit page 34.
[cviii] ibid page 33.
[cix] HIV/AIDS in PNG – Fact sheet. AusAID. Australian Embassy, Port Moresby, PNG.
[cx] The Economic Impact of HIV/AIDS epidemic in Papua New Guinea. Report prepared for AusAID by the Centre for International Economics, Canberra, May 2001.
[cxi] The Global governance of trade as if development really mattered. Dani Rodrik. op cit. Page 15.
[cxii] Assessing Aid – What Works, What doesn't and Why op cit page 12.
[cxiii] Aid and Reform in Africa. World Bank publication. 2001 page 103
[cxiv] ibid page 119
[cxv] ibid page 103.
[cxvi] ibid page 137. Importantly, the report then goes on to note that just as the government acquired full ownership of the reform program from 1992 onwards the aid to GDP ratio started to decline. The report notes "to have maximum effect on poverty reduction, aid should have increased over subsequent years at least in tandem with the policy improvements" but this did not happen..
[cxvii] Australian aid – investing in growth, stability and prosperity op cit page 47.
[cxviii] *The role and effectiveness of development assistance* in A Case for Aid. World Bank publication. 2002. page 33.
[cxix] *Fifty years of development*. Nicholas Stern, Chief Economist, World Bank in A Strategy for Development. World Bank 2002.
[cxx] Stiglitz. Globalisation and its Discontents op cit page 20.
[cxxi] Rodrik op cit page 24.
[cxxii] Quoted in *A* World Without Walls – Freedom, Development, Free Trade and Global Governance by Mike Moore. op cit page 50.

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