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CONTENTS

LIST OF TABLES

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ABSTRACT

This paper surveys issues related to globalization, and the obstacles to the successful integration of vulnerable economies. For many developing countries, the positive benefits of the increased globalization that has been taking place since around 1980 remain distant and elusive. The economies of many countries in the developing world remain extremely vulnerable to domestic and external shocks. They have, effectively, become marginalized from the world system. To a great extent, the obstacles to the successful participation of vulnerable developing economies in the international system are rooted in the causes of their underdevelopment and poor economic performance. Nevertheless, the new rules of the game and the international economic environment prevalent since about 1980 following *accelerated globalization*, leaves them vulnerable in novel ways. Developments in the arrangements for conducting multilateral trade and technology transfer have left nations in the South more vulnerable than in the past. The ability to conduct independent macroeconomic policy is severely constrained. Nations are more reliant on volatile international capital markets, for finance and investment; many developing countries are completely eschewed by international private capital markets. The problem of poverty in many developing countries seems to have been exacerbated following globalization. When we consider the obstacles to the meaningful participation of vulnerable developing economies in the international system, many are domestic in origin, but external factors beyond the control of these countries play an important part as well. Among the former are poorly designed policies to promote growth on the supply-side, macroeconomic mismanagement on the aggregate demand side and institutional failure. In the latter category protectionist tendencies in the North are the most important factor. Many of these appear in the guise of concerns for environmental and labour standards. Globalization does, however, offer new possibilities to developing countries; particularly because shifts in the international division of labour, as well as technological innovations, could favour the South.

1. INTRODUCTION

The term globalization is used rather ambiguously. Within the sphere of economics, Nayyar (1997) points out that it is used in the positive sense to denote the increased international integration of trade, investment and finance; it is also employed in the normative sense to denote a reaction to increased integration, and the policies that follow from there. Globalization and openness are not new phenomena. The period before the First World War offers parallels to the present day in terms of a highly integrated world economy measured by a high degree of international trade, foreign direct investment (FDI), as well as financial flows (portfolio investment and direct lending to banks and governments). During the inter-war period this highly globalized economy became inward looking, and the process of globalization was reversed. As Sachs and Warner (1995) indicate, since about 1960 the barriers to globalization were once again dismantled. This was often a slow process, and many developing countries chose not to participate, at least initially. International trade was the first to be liberalized. FDI followed suit, and finally it was the turn of financial flows. Milanovic (1999) argues that the present phase of globalization began at a date long after 1960, as at that time at least a quarter of the world's population lived under socialist systems.[1] Globalization, therefore, requires one type of economic system (capitalism in this case) to be almost ubiquitously present. A convenient approximation to mark the commencement of present day globalization could be circa 1980, following China's adoption of open-door policies.

Globalization implies the accelerated integration of the world economy, not just at the regional level. In principle, this should offer poorer countries an opportunity to grow faster and catch up with more affluent countries. This is the stuff of conventional growth theory. But another process could also be in operation. Globalization may serve to cement the polarization between rich and poor. This polarization has been described by Quah (1996) as the 'persistence and stratification' of the differences between rich and poor. The world's economies can be drawn from two distinct clubs or income distributions: a rich set and a poor group. Over time, when offered growth prospects, such as with our present spate of globalization: (a) many

[1] Milanovic (1999) proffers the interesting hypothesis that the Roman Empire represented the first wave of globalization. While this can be argued to be the case in terms of cultural integration in the Western Hemisphere, production in Roman times was not akin to the manufacturing processes discovered after 1700.

poor countries continue to be poor; (b) many rich nations remain rich; (c) some poor countries rise to the ranks of the rich; and (d) some comparatively affluent countries descend into relative poverty.

Globalization can, therefore, produce winners and losers. At present, as in the past, it appears to benefit countries of the North disproportionately more than in the South. Nayyar (1997) indicates that 11 developing countries account for 66 per cent of total developing country exports, as well as receiving the lion's share of FDI inflows. Thus, even within the South the gains from globalization have been highly asymmetric. For many developing countries, the positive benefits of the globalization that has been taking place since around 1980 remain distant and elusive. More often than not, globalization simply implies the equalization of prices towards Western levels, but not of incomes and living standards (Nayyar 1997). The economies of many countries in the developing world remain extremely vulnerable to domestic and external shocks, and they seem unable to cash in on the increased internationalization of the world economy. They are, in many senses of the term, marginalized from the world economic system. Yet opting out of the present day globalized economic system is not a seriously viable alternative for any country. To a great extent, the obstacles to the successful participation of vulnerable developing economies in the international system are rooted in the causes of their underdevelopment and poor economic performance. Nevertheless, the new rules of the game and the international economic environment prevalent since about 1980 following *accelerated globalization*, leaves them vulnerable in novel ways.

Many of the obstacles to the meaningful participation of vulnerable developing economies in the international system are domestic in origin, but external factors beyond the control of these countries play an important part as well. Among the former are poorly designed policies to promote growth on the supply-side, macroeconomic mismanagement on the aggregate demand side and institutional failure. In the latter category protectionist tendencies in the North are the most important factor. Many of these appear in the guise of concerns for environmental and labour standards. Other protectionist tendencies in the North towards the South are motivated by the so-called 'pauper labour' argument: trade with developing countries will disadvantage unskilled workers in developed economies. Globalization does, however, offer possibilities to developing countries; particularly because the international division of labour is altering in favour of the South. Also, in recent years South-South linkages are growing as well. Yarborough and Yarborough (1997) indicate trade with partners in the South was about 40 per cent of total developing countries' trade in 1992, compared to only 27 per cent in 1968.

It is worthwhile attempting to clarify the terms 'small' and 'vulnerable'. In traditional economics, smallness refers to the nation state's inability to affect world prices and interest rates. If that definition is followed then all countries except the USA, Japan and the EU Euro zone are small. But these are developed countries, and are excluded from the nations whose experience concerns this paper. Another measure of smallness could pertain to demographic size. But such smallness is not always associated with economic weakness. For example, the absolute size of Singapore's GNP with 3 million inhabitants is ranked 33rd in the world, and it has the second highest per capita GNP in purchasing power parity terms.[2] Bangladesh's GNP, on the other hand, with a population of 122 million, is the 51st highest in the world, and is 116th in terms of purchasing power parity per capita GNP. Thus, in spite of being 40 times larger than Singapore in terms of its population, it has a smaller economic size. Certain populous economies, such as Bangladesh, can be considered 'small' in economic size, despite their substantial population.

Then we come to the question of vulnerability. All economies are susceptible to demand and supply shocks, as well as the vagaries of the rapidly shifting pattern of competitive advantage. Some countries, however, are in a better position to cope, as they are richer. Others, including affluent and not so affluent nations, are more adaptable to the changing world economic climate. Vulnerability may be characterized in several ways. The most common definition is related to a weak and undiversified production/export structure, which is prone to shocks and fluctuations in earnings. Some authors, such as Auty (1997), have defined this as the 'staple' trap. This is a situation when the economy depends on a narrow range of staple products. A second notion of vulnerability may be linked to a low endowment of 'institutional' capital. By this we mean the various institutions and mechanisms that are necessary for the enforcement of contracts, regulation and implementation of policies. When this institutional stock is absent or has been allowed to run down; this can defeat the best policies and result in many lost opportunities. Finally, an economy is vulnerable if its structure is less capable of adapting to changing market conditions. All of the three concepts of vulnerability can, of course, be inter-linked. They often manifest themselves in the form of

2 Computed from World Bank (1998).

poor human capital endowment, inadequate infrastructure, faulty governance and the heavy reliance on a few staple exportables.

It is important to emphasize the newer vulnerabilities engendered by the rapid pace of globalization during the past two decades. There are the cumulatively debilitating effects of the oil shocks of the 1970s and the debt crisis of the 1980s, which have left many economies in a weak position. The imposition of structural adjustment as well as multilateral donor conditionality has resulted in much less room for manoeuvre in the macroeconomic sphere. Countries are more reliant on volatile international capital markets for finance and investment. Furthermore, developments in the arrangements for conducting multilateral trade and technology transfer have left nations in the South more vulnerable than in the past. The problem of poverty in many developing countries seems to have increased. The combined effects of globalization and structural adjustment has contributed towards making the income distribution more skewed, even in countries where per capita incomes have risen (Cornia 1999b). As will be seen below, the last quarter century has driven the widest ever wedge in human history between average incomes in rich and poor nations. Globalization is part of a process of economic transformation that rewards the few at the expense of the many.

We exclude the experience of present day China, India, the larger Latin American countries and the East Asian NICs in the study that follows. Given this proviso, this paper will be concerned with the problems confronting developing countries that fall within the UN least developed economy grouping and beyond; say to the World Bank definition of low-income developing country. For example, the UN least developed country grouping consists of 48 countries (UNCTAD 1998). The World Bank (1999) definition of low-income economies[3] (those with a per capita GNP US$ 785 or less in 1997), extends this UN definition to other countries, arriving at a total of 61 countries. A few of the UN least developed countries are, however, not 'low-income' nations according to the World Bank classification. Cape Verde, for example, as their per capita GNP exceeded US$ 785 in 1997. Be that as it may, to obtain a flavour of the plight of least developed or 'low-income' nations note that the two categories comprise 10.4 per cent and 35 per cent respectively of the world's population. Yet their average per capita income in 1997 was only a meagre 5 per cent and 6.8 per cent respectively of the world average.

3 Includes India, whose experience will not directly form part of this study.

The rest of the paper is organized as follows: section 2 briefly outlines the salient differences between our present experience of globalization with the previous episode a century ago; section 3 sketches a picture of unsuccessful international integration; section 4 is concerned with domestic obstacles to integration; section 5 considers international obstacles; and, finally section 6 puts forward some conclusions and policy implications.

2. GLOBALIZATION IN THE PAST

It is said that the past informs the present. This section is not meant to be an exhaustive summary of the differences between present and past globalization, but will be concerned with the salient differences between the two episodes. The period between 1870-1914 was an era of unprecedented international economic integration in terms of trade, FDI and other types of investment as well as capital flows. Let us take the example of merchandise trade. Figures cited in Krugman (1995) indicate, for example, that the share of trade in the UK's GDP was 27.7 per cent in 1913, declining to 13.1 per cent in 1950 and recovering to 21.1 per cent in 1987. The same figures, for a more inwardly oriented economy, the USA are 3.9 per cent, 2.9 per cent and 7.4 per cent respectively. In the case of Germany they are, 19.9 per cent, 9.8 per cent and 23.3 per cent. Thus the world economy, in terms of the value of trade, has recovered to its pre-First World War golden age, after an inward looking half century, particularly during the inter-war period. Since about 1965 world trade has been growing faster than world output growth; and after 1985 foreign direct investment (FDI) has been rising more rapidly than export growth.

Within the realm of financial flows, Bordo *et al*. (1998) indicate that there are fewer informational asymmetries at present compared to the previous phase of globalization. This is principally a result of the IT revolution, and the perfect information flows that this entails. Asymmetrical information leads to less than perfect markets, particularly in the case of financial markets. Hence, it may be argued that in our present world of instant and perfect financial information, the quality of world financial market integration is deeper than in the past. The quantitative volume, however, of international financial flows was at least as great in 1900 when compared to 2000.

Williamson (1999) makes the important point that 19th century globalization was triggered-off not just by trade and capital flow liberalization, but also by falling transport costs and mass migration from Europe to the 'new' world. Falling transport and communication costs, driven by the invention of the steamship and the telegraph, were the most significant aspect of technical progress then, just as the information technology (IT) revolution is now.[4] It must be remembered that international trade was less free of trade taxes (or artificial trade restrictions) in the last century when compared to the present. Granted, the UK and Denmark pursued free trade. But the USA, Germany, France and Russia had considerable import tariffs in place. This was in the interests of their landed classes and other producers. Britain had free trade, because it suited her; it pushed up real wages as food prices declined without raising nominal wages: a positive terms-of-trade effect on 'aggregate supply'. British free trade also served as an engine of world growth much like the role played by the USA at present. Today's liberalization is, by contrast, much more about reductions in artificial or policy-induced trade barriers, and less to do with movements of people. Technology is a key factor, then and now. The globalization of the 19th century was mainly to do with inter-industry trade, for example grain from Canada in return for European manufactured goods and investment. Today's globalization is about intra-industry trade in *manufacturing* only.

To give ourselves a lesson in economic history: up to the mid-19th century there was a divergence in real earnings between the 'new' world and Europe, Australia and USA enjoyed the higher wages. Globalization in the 19th century, which is said to have occurred post-1870, implied the *convergence* of real wages (and wage-land rental ratios) in the 'Atlantic' economies, as described in Williamson (1999). There was a catch up of real wages all over Europe towards the higher levels of the same in the USA. Furthermore, there was also an intra-European convergence, Ireland and Scandinavia doing the main catching up. Nordic countries moved from the periphery to the centre during the pre-1914 globalization, with Sweden and Denmark doing best. Austria did well, but Italy performed poorly, the Iberian Peninsula fared worse, as did much of South Eastern Europe. Irish wages grew and moved towards British levels as the result of mass emigration. Significant emigration also took place from other parts of Europe. These convergence trends collapsed under the relative autarky of 1914-50.

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4 One could argue that declining transport costs, induced by technological innovation, was akin to a 'natural' reduction in trade barriers. Trade restrictions imposed by governments can be described as 'artificial' restrictions.

The same Atlantic economies, with new European countries added, continue to be successful in present day globalization. This process of globalization is akin to integration outlined in Krugman (1991). The convergence in earnings is also predicted by the factor price equalization theorem in the Heckscher-Ohlin-Samuelson (HOS) model of free trade. In general, meaningful participation in globalization implies that some measure of income (per capita or average real wages) converges to higher-income countries as economies integrate.

A question mark remains over why much of the third world was, and still remains, excluded, in terms of economic convergence, from both episodes of globalization. In the 19th century Latin American economies, such as Argentina, were the successful 'third-world' globalization players, not unlike today's East Asia. The Taiwan and South Korea of today may have had parallels in Australia, Sweden and Denmark, circa 1900.

It is worthwhile briefly examining figures on the inequality between richer and poorer nations. One approximation is the gap in average or per capita incomes between the richest and poorest countries in the world. UNDP (1999) reproduces figures to show that this gap was only 3:1 during the dawn of the industrial revolution in 1820, rising to 11:1 by the end of the first episode of globalization in 1913. More recently, it grew to 35:1 in 1950, rising slightly to 44:1 by 1973. More recently, after the commencement of the present round of globalization, this figure has acquired a staggering magnitude of 72:1. Accompanying this widening gap is the grave human cost in terms of malnutrition, morbidity and mortality. It is estimated that those living in abject poverty number some 700 million individuals, residing mainly in sub-Saharan Africa and South Asia. This is the most conclusive evidence of the marginalization of some nations and groups from the process of globalization.

Baldwin and Martin (1999) point out that both phases of globalization produced per capita income convergence between richer countries (the Atlantic economies of Williamson 1999), but produced greater North-South income divergence. More interestingly, they allude to the important, but often ignored historical fact that the industrialization of the North preceding 19th century globalization was at the expense of the South. Bairoch (1982) presents evidence that China and India were just as industrialized as the parts of Europe (such as England) who had developed manufacturing. Market penetration by Britain following colonialization caused the manufacturing sectors in these countries of the South to vanish. The great first wave of globalization came later associated with catch-up by several other 'Atlantic' economies, but producing a sizeable North-South income gap for the first time. This gap has been widened during the more recent globalization experience. Baldwin and Martin (1999), however, argue that in the present globalized context knowledge or 'ideas' spillovers are less costly than a century ago. This has enabled a (small) part of the South to industrialize, whereas the manufacturing share of employment has dwindled in the North. It offers a window of opportunity to poorer countries given the current pattern of consumption where product and brand innovation plays a leading part. But the barriers to entry to such a process of industrialization are still very formidable.

Williamson (1999) makes an important point about globalization backlash. During 1870-1914, income inequality rose in the USA as landowners gained from trade and mass migration, whereas the opposite effect took place in Europe. Around 1914 there was a pronounced resentment to the forces of globalization, particularly mass migration. Trade in the 19th century had a classic HOS effect, it raised the relative return to the factor used intensively in exports. The 'new' world exported agricultural/mineral commodities, and land was the important factor whose return rose. In Europe it was manufacturing and the real wages of skilled labour rose. In the New World the disadvantaging effect of trade on wages was augmented by mass migration driving down wages even further. Thus immigration restrictions crept into the 'new' world even before 1917. In Europe protectionism took the form of trade restrictions. France, for example, restricted trade in grain, raising the real wages of agricultural workers.

There are similar processes in train in present day globalization, which has also produced substantial inequality within richer countries.[5] The disadvantaged, in terms of real wages or employment, are unskilled workers in the North. This has more to do with technical progress (process and product innovation as well as capital deepening) and the product cycle with new goods or brands being innovated. Any backlash to globalization is likely to be much more muted at present. Unskilled workers in the North receive social security benefits. Trade restrictions do exist, but they are subtle and selective, non-tariff barriers directed mainly against third-world interests.

5 Income inequality seems to have declined during the less integrated period of 1950-73. During the most autarkic period in between the two world wars, inequality fell in the USA during the 1930s.

In summary, there are important differences in our present experience of globalization when compared to the previous episode, a century earlier. The first is to do with the nature of trade. There is an increased amount of intra-industry trade, compared to the inter-industry trade of the last century (or even half a century ago). Within the category of intra-industry trade there is also a great deal of intra-firm trade. This is what is described by Krugman (1995), as the vertical disintegration of production, or 'slicing up the value chain'. Essentially this refers to the process by which different components of a particular product could be produced in several parts of the world. The second difference stems from the fact that present day FDI is more concentrated: Nayyar (1997) points out that developing countries account for only 22 per cent of the stock of FDI in 1992, compared to 45 per cent in 1914. Thirdly, a large proportion of international financial flows is confined within the North, going to finance government expenditure rather than productive investment. Fourthly, unlike in the previous century international labour mobility is extremely restricted, and confined only to the highly skilled, see Baldwin and Martin (1999), among others on this. Lastly, the political environment is quite different. Around 1900 colonialization and gunboat-diplomacy were rife, and these were the means utilized to impose the will of the hegemonic powers. By contrast, we live in a world where electorates and other groups (the eponymous Non-Governmental Organizations) wield a great deal of influence. Also, there is a greater use of multilateral organizations and rules in the governance of international economic relations.

3. THE ANATOMY OF UNSUCCESSFUL INTEGRATION

3.1 Output and production

One of the clearest symptoms of the lack of economic success is poor performance in terms of economic growth. Failure to achieve acceptable rates of economic growth is also connected to the inability to benefit from a globalizing world economy. As is indicated in Table 1 below, the sub-set of vulnerable economies defined by the UN as the *least* developed country group experienced poor growth rates during both the 1980s and 1990s. Their growth rates were below the average for developing countries as a whole. A more telling picture emerges when we examine real per capita income levels. For the least developed economies they have remained stagnant between 1980 and 1996. Geographically speaking, countries in East Asia and the Pacific have been the most successful in the past two

TABLE 1
GDP GROWTH RATES AND PER CAPITA INCOME LEVELS IN SELECTED REGIONS AND COUNTRIES

Area/Country	1990-96 (% annual average GNP growth)	1980-90 (% annual average GNP growth)	1996 per capita income level in 1996 US $	1980 per capita income level in 1996 US $
All Developing Countries	2.9	3.1	1350	985
UN Least Developed Countries	2.2	2.6	228	227
East Asia and the Pacific	10.2	7.7	1190	
South Asia	5.6	5.7	380	
Latin America and Caribbean	3.2	1.8	3710	2334
Sub-Saharan Africa	2.0	1.7	490	594
Bangladesh	4.3	4.3	259	174
Tanzania	4.0	2.7	171	173

Sources: UNCTAD (1998), Least Developed Countries Report, World Bank (1998), World Development Indicators and IMF (1997), International Financial Statistics Yearbook.

decades. Sub-Saharan Africa has been lagging behind most, with unimpressive growth rates and a substantial decline in real per capita income. Unlike Latin America, it does not appear to have bounced back from the lost decade of the 1980s.

Two observations are in order at this juncture. The first is to do with the fact that an indifferent growth experience can also be related to non-economic factors such as the presence of internal or external conflict. Not all poorly performing economies are, however, victims of wars. Secondly, the average figures for the geographical regions cited above often disguise considerable variations in individual country performance within the geographical grouping. For example, Bangladesh has had lower growth rates than the South Asian average, and its per capita income is about two-thirds of the figure for the whole of South Asia. Tanzania, on the other hand, has recently performed relatively better than the sub-Saharan average.

When we examine the structure of production, the share of manufacturing in the GDP of the least developed economies and sub-Saharan Africa is below the average for all developing countries (Table 2). Manufacturing is considered to be a more dynamic sector when compared to agriculture and other natural resource based sectors such as mining. Furthermore, commodity prices, and hence exports based on primary products, are subject to wider fluctuations than manufactured or service sector exports.[6] Also, there is some evidence that a slower pace of growth accompanied by the lack of industrialization is sometimes linked to a rich natural resource endowment, and a heavy reliance on the export of these commodities, see Auty (1997).

TABLE 2
GROWTH IN MANUFACTURING IN SELECTED REGIONS AND COUNTRIES

Area/Country	1990-96 (% annual average growth)	1980-90 (% annual average growth)	Manufacturing value added as a % of GDP (1996)
All Developing Countries		4.5	22
UN Least Developed Countries	2.6	7.5	10
East Asia and the Pacific	15.0	9.7	33
South Asia	7.4	7.2	19
Latin America and Caribbean	2.6	1.2	21
Sub-Saharan Africa	0.8	1.3	15
Bangladesh	7.3	2.8	10
Tanzania	3.6	1.1	7

Sources: UNCTAD (1998), Least Developed Countries Report and World Bank (1998), World Development Indicators.

6 According to the IMF (1998), non-fuel primary commodity prices rose by an average of 0.6 per cent during the 1980s, with a projection for 0.2 per cent price increases during the 1990s.

Table 3 displays the major manufactured exports of the least developed countries. These items sum to 27.9 per cent of total exports from these countries. Even here we find a reliance on manufactures that are natural resource based (SITC nos. 682 and 667). The other manufactured goods exports are drawn from unskilled labour intensive categories. Of 28 least developed countries, 26 still obtain more than 70 per cent of their export earnings from primary commodities. Furthermore, only about 12 of them were recently able to reduce their export concentration ratio.[7] This experience of most of the least developed economies is in marked contrast

TABLE 3
MANUFACTURED EXPORTS OF SELECTED PRODUCTS BY LEAST DEVELOPING COUNTRIES

SITC	Commodity	% Contribution towards total exports of least developed economies	Least developed country exports as a % of total developing country share
682	Copper	6.2	9.2
667	Pearls and precious and semi-precious stones	5.2	9.5
844	Under garments of textile fabrics	3.9	7.4
843	Outer garments (women's)	3.5	2.8
524	Radioactive materials	2.6	53.2
846	Under garments	2.5	3.5
842	Outer garments (men's)	2.4	2.7
845	Outer garments of other articles	1.6	1.5

Source: UNCTAD (1998), Least Developed Countries Report.

Note: Manufacturing commodity classifications are based on standard international trade classifications (SITC), at a three-digit level.

7 See UNCTAD (1998); also, Patel *et al*. (1997).

to the more successful developing countries in East Asia, see Table 4 for their growing world market shares in many manufactured goods exports. There is also considerable evidence suggesting that many of these countries are moving up the quality ladder and diversifying into other more technologically sophisticated manufactured exports (SITC nos. 724 and 725 in Table 4).[8] The least developed economies are, therefore, not benefiting from the new division of labour and the shifting comparative advantage from North to South in many manufacturing activities. This fact is illustrated by the following summary statistic: in 1991, the share of primary commodities in the total exports of least developed countries was 57 per cent, compared to 18 per cent for all developing countries.

TABLE 4
SELECTED DEVELOPING COUNTRIES EXPORT SHARES OF CERTAIN MANUFACTURES (PERCENTAGE OF WORLD EXPORTS)

SITC Code	Commodity	1985	1990
652	Cotton fabrics, woven	30.2%	39.5%
653	Woven textiles, non-cotton	24.9%	32.6%
724	Telecommunications equipment	20.3%	28.1%
725	Domestic electric equipment	16.0%	22.0%
831	Travel goods, handbags	59.2%	59.1%
841	Clothing, not of fur	42.8%	39.8%
851	Footwear	37.2%	43.7%

Source: OECD (1995) *Linkages. OECD and Major Developing Economies*, Paris: OECD.

Note: The selected countries are: China, South Korea, Taiwan, Singapore, Hong Kong, Indonesia, Thailand and Malaysia.

Moving on to the service sector, exports from this category have outstripped growth in world merchandise trade, and developing countries as a whole are experiencing faster growth in service sector exports relative to developed countries. Service sector exports account for about a quarter of all exports. For the least developed economies, service sector exports contribute some 22 per cent towards total export earnings. But as far as

8 See also Murshed (1999).

they are concerned, the reliance is on the lower quality end of service sector exports.[9]

3.2 Aggregate demand side

When we examine the aggregate demand side, it is not surprising that most vulnerable and less successful economies in the world are characterized by low savings rates (Table 5). The UN defined least developed economies have savings rates that are less than half of the developing country average. Latin America and the Caribbean, as well as sub-Saharan Africa also have below average savings rates. Besides being a cause, low savings rates, can equally be a symptom of lacklustre economic development and poverty.

TABLE 5
SAVINGS RATES IN SELECTED REGIONS DURING 1996 (% OF GDP)

Region	Savings rate as a % of GDP
UN Least Developed Countries	10.5
East Asia and the Pacific	38.3
Latin America and the Caribbean	20.3
South Asia	21.6
Sub-Saharan Africa	17.9
All Developing Countries	24.2

Source: World Bank (1998), World Development Indicators.

Looking at the net resource balance (investment less domestically financed saving as a proportion of GDP) we find this to be negative, as expected, for most developing countries. This is because poorer nations are capital importers. For the least developed group the resource (im)balance is –12 per cent of GDP, compared to –0.7 per cent for all developing countries, (World Bank 1998). This reflects vulnerability: a greater dependence on external sources for financing domestic absorption, especially official development assistance (ODA). According to UNCTAD (1994), the real value of ODA to the UN least developed countries increased three-fold between 1970 and 1992.[10] This is partly a reflection of the various humanitarian emergencies in some of these countries, but also because of the continuing presence of poverty and the inability to attract foreign

9 See Hirst and Thompson (1996) and UNCTAD (1998).

10 From US $ 0.6 to US$ 1.8 billion in 1970 constant dollars.

private capital. Net private inflows are a very small fraction of total net foreign inflows into the less successful economies of the developing world. In many years there are negative foreign capital inflows, due to the factors such as capital flight from these unstable countries. All in all, the sum of low growth, rising debt servicing, wars and natural calamities implies that this increased ODA goes mainly towards financing (private and government) consumption, as well as debt servicing rather than productive investment.

Most vulnerable economies continue to suffer greatly under the burden of debt servicing and substantial debt stocks relative to national income. The average stock of debt as a proportion of GNP is about 90 per cent for the least developed countries (World Bank 1998). If we examine the flow of annual debt servicing as a percentage of export earnings, say in 1996, the figure is about 15 per cent. There are, of course, variations around these figures for individual countries. For example, Bangladesh's debt servicing required about 8 per cent of export earnings in 1996, for Zambia the corresponding figure was 25 per cent. The burden of debt tends to be greater in Latin America and the Caribbean, as well as sub-Saharan Africa. It constitutes a great drain on resources and hinders economic recovery via the mechanism of debt overhang, whereby excess debt servicing inhibits investment. More recently, there have been initiatives at debt relief for the poorest countries, even at the level of the G-7 summits. The present proposals, initiated by the UK and German governments, propose up to US$ 50 billion of debt relief after a period of 3 years' structural adjustment under the tutelage of the IMF. Although this proposal does go quite far in the way of debt relief, the country coverage (it excludes Liberia, Somalia and the Sudan) is less than the 52 poor nations identified by pressure groups such as Jubilee 2000. There remain stumbling blocks towards debt-relief on multilateral debt (EURODAD 1999). A considerable amount of total debt is owed to the international financial institutions (IFIs) such as the IMF and the World Bank. Multilateral debt relief is meant to be financed by the sale of gold reserves of major shareholders held at the IMF. Opposition to such sales in the member countries owning the gold is strong, particularly among gold mining interests.

Vulnerable economies attract very little foreign direct investment (FDI). The least developed country group accounted for only 1.5 per cent of total FDI to developing nations as a whole. FDI flows to this group were only 2.1 per cent of total financial flows to these countries. The corresponding figure for all developing economies is 31 per cent. When FDI does occur in the more vulnerable economies it tends to concentrate on mining, other natural resource based industries and tourism (UNCTAD 1998).

The macroeconomic vulnerability of many developing countries is compounded by variations in export earnings from year to year. These can be caused by both supply-side phenomena at home, and demand related fluctuations abroad. Whatever the reason, it causes public finances to be susceptible to the vicissitudes of export earnings. In summary, many vulnerable and unsuccessful developing countries often need to service substantial debt, are dogged by low saving-ratios, as well as being heavily dependent on aid as the principal source of international finance. All of these features contribute to the phenomenon of vulnerability.

4. DOMESTIC OBSTACLES TO SUCCESSFUL INTEGRATION

4.1 Location and agglomeration effects

There is a long tradition in the literature of economics emphasizing the importance of location in promoting economic growth and prosperity. Marshall (1920) described the concentrated development of industry in the North of England during the early industrial revolution. Firms gained from the presence of other firms because of: (i) pooled markets for skilled labour, (ii) access to intermediate inputs and services at the same location, and above all (iii) gaining from technological or know-how spillovers from other firms in the vicinity (an externality). Although this analysis was concerned about agglomeration within the context of a nation state, it has important implications for the development of groups of physically proximate nations. Many of these arguments about the clustering of production, knowledge, and competitive advantage have been made famous by 'Porter's' paradigm (Porter 1990). Porter's ideas were heavily utilized to rationalize the industrial development of East Asia. By implication, they may also be applied, utilizing reverse causality, to explain the lack of success of the more vulnerable economies in the world.

In short, the main thrust of this approach, known somewhat controversially as the new economic geography, is to suggest that location matters when it comes to sustained industrialization and growth. Krugman (1991) analyses the development of centres and peripheries. Initial conditions, historical accidents, expectations and political decisions are of crucial importance. Initial conditions related to demand factors, market size (economies of scale) and transportation costs, when the world economy takes-off or globalization starts are important in determining whether a country eventually becomes peripheral or not. These favourable, or unfavourable, initial conditions tend to *persist* over time via agglomeration effects. The choice of correct policies, at an early stage, is of paramount value. Historical accidents and political decisions about integration and separation also contribute to long-term development. For example, Canada's political decision about being separate from the USA may have prevented its becoming a peripheral region. Sometimes expectations, even if slightly out of tune with current reality, play a part. Thus, even when a nation adopts the right policies and enjoys favourable conditions, capital may not flow there. Krugman and Venables (1995) demonstrate that with a monopolistically competitive industrial structure globalization (in the sense of increased world integration and the removal of barriers to trade) can produce many losers. Autarky allows some industries to survive everywhere, whereas globalization causes the weak (or inefficient) to go to the wall.[11] Monopolistic competition is the appropriate type of industrial organization to describe much of present day manufacturing production with its emphasis on variety, product innovation and customized brands. Puga and Venables (1999) present a multi-sector model, which characterizes industrial development in terms of locational agglomeration effects between firms, located at close physical proximity. This encourages geographical concentration of production. But this concentration can spread from one part of the world to the other.

Another literature puts greater stress on pure geographical position as a *fixed* factor governing long-term economic development. It is concerned mainly with the recent poor economic performance in sub-Saharan Africa. The central thesis of Bloom and Sachs (1998), as well as Gallup *et al.* (1998), is that there are two factors, impacting like fixed costs that disadvantage Africa. These are (1) tropical Location and (2) demographic burden. It should be noted that Africa's recent economic indicators have been appalling. Per capita income between 1985-96 was falling, at a rate of 0.6 per cent per annum on average. There is also evidence that Africa is the only region in the world where school enrolment, life expectancy and per capita exports declined in recent years.

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11 Baldwin and Martin (1999) discuss such a model in the context of the two phases of globalization. In the first phase, endogenous growth and agglomeration affects result in the North being the only industrialized world region. But with a freer movement of 'ideas' the South too can be industrialized, as is the case in East Asia at present.

The tropics, especially tropical Africa, is said to have lower agricultural productivity compared to the mid-latitudes, where most of humanity resides. Low population density in Africa is also said to prevent agglomeration effects. The presence of monsoon rains plus a dry season later in the year is supposed to raise agricultural productivity in tropical East and South Asia. A lot of sub-Saharan Africa is extremely vulnerable to drought, has the highest variance around annual average rainfall, and a lot of coastal East Africa is hot and arid. Only 4 per cent of cropland is irrigated in Africa, compared to 35 per cent in South Asia and 52 per cent in China. More to the point, transportation is most difficult in Africa, because of distance from the coast and also the absence of navigable rivers capable of coping with ocean going ships as in China, India etc. Only 19 per cent of Africa's population live within 100 kilometres of the coast. The demographic transition, meaning the switch from high fertility and mortality to low fertility and mortality, has not yet taken place in Africa compared to Asia and Latin America. Also, there is said to be a special disease burden in tropical Africa, involving infectious and parasitic diseases, such as malaria. Furthermore, it is suggested that the poor geographical and demographic endowments in Africa can in turn cause policy failure and hinder good governance.

Other commentators such as Paul Collier, discussing Bloom and Sachs (1998) place greater emphasis on policy failure rather than fixed locational factors. Collier argues that the greatest problems with Africa are inadequate infrastructure, high transaction costs (bribery and no contract enforcement), and political risk. Policy failure in the recent past can lead to *hysteresis*, even after policy failures are corrected. Africa, he argues, may have just missed the boat, the chance to export labour intensive manufactured goods.

In summary, the literature on the role of location and agglomeration effects in economic development, and the new economic geography, does have important policy implications. These are the importance of the development of infrastructure and institutions, as well as health and educational investment. The object of these policies is to counteract locational disadvantages, or sustain currently held advantages. Policies do matter: to paraphrase David (1999), current economic geography may actually reflect history, but geography need not be immutable destiny.

4.2 Capital formation and growth

Ever since the pioneering work of Romer (1986, 1990) and Lucas (1988), where growth is seen as an endogenous process, interest has shifted to the factors promoting growth. Broadly speaking, the single most important factor identified is investment in education leading to the formation of human capital. Other factors include infrastructure, principally transportation and communication. Human capital aids growth either as an externality (endogenous growth theory mark 1), or as a direct input into the R&D process (endogenous growth theory mark 2). In the former case, human capital externalities compensate for decreasing returns to capital, allowing for high and sustained growth rates without exogenous technical progress.[12] In the latter case, it is imperfect competition (specifically monopolistic competition) that endogenously drives high growth. Knowledge, in the form of R&D, is an input and not an externality. In summary, irrespective of whether knowledge (basic education in developing economies) is an externality or a direct input there are perceived gains from policy driven investment in education.

All of the issues raised in the previous paragraph are related to the production function. A second question addressed by the new growth theory is connected to why poor countries stay poor, and do not catch up via higher growth rates to income levels in richer economies. There is the notion of 'convergence clubs'. The growth rates of countries sharing common characteristics converge: be that to high or to low-income levels.[13] Theoretical explanations for this phenomenon range from threshold externalities (a certain critical mass of capital required for sustained high growth) to stronger human capital type spillover effects between certain groups of countries.[14] From the viewpoint of those countries that have been unsuccessful following the rapid globalization of the past two decades this issue is of great interest.

We have to ask ourselves what the empirical evidence about endogenous factors tell us regarding the growth experience of vulnerable and unsuccessful economies in recent times. It is useful to begin by looking at the experience of the successful, say the East Asian group. According to a study conducted by the World Bank (1993), the pride of place for the East Asian growth miracle is attributable to education. This suggests that the policy implications of endogenous growth theory are valid. A contrary view can be found in Young (1995), who suggests that the high growth rates in the East Asian region are mainly due to the accumulation of capital

12 The formulation of the externality differs in Romer (1986) and Lucas (1988). In the former case it augments the productivity of physical capital, and in the latter labour.

13 For a survey of this voluminous literature see Durlauf and Quah (1998).

14 On the former see Azariadis and Drazen (1990), and on the latter see Lucas (1993).

and other factors of production. This would have been the policy prescription of the 'old' growth theory. Thus, the empirical evidence is far from conclusive.

In a study, which analyses the poor economic performance of sub-Saharan Africa, Freeman and Lindauer (1999) closely examine the impact of education on growth rates. In addition to methodological questions about modelling education and growth; the paper concludes that investment in education, in itself, is not a sufficient condition for sustained high growth rates. This does not mean that spending on education, particularly at a primary level, is an unimportant policy. For example, Lall (1999) demonstrates compelling evidence that the few developing countries that have been successful in attracting inward investment and technology transfer have also invested considerably in education as well as R&D. What may be of relevance are the complementary factors to education. In the African context, private returns to education could be low, especially in the absence of a green revolution in agriculture, and a rise in manufactured goods exports (Asia) expenditure on education might fail to generate returns. Nevertheless, Ramachandaran and Shah (1999) find that in three African economies: Zimbabwe, Ghana and Kenya, the gross value added by firms is higher where the majority ownership of the firm is foreign, when compared to indigenously owned firms in the same industry category. Skills and technological know-how are key factors in explaining this difference.

4.3 Institutional capital and social conditions

There is a considerable body of literature stressing the importance of institutions and the governance structure in promoting economic development. For example, two countries may have similar endowments of labour, physical and human capital. But in one country a flawed system of governance and an incomplete set of institutions or the paucity of social infrastructure might make these factors of production less productive. A good governance structure implies minimal corruption and wasteful rent seeking, along with efficient regulation. According to Hall and Jones (1999) these institutions prevent the diversion of the output of an economy into wasteful activities. For example, if an entrepreneur has to pay a lot of bribes to establish production it adds to fixed costs and lowers the profitability of investment. Similarly, seeking bribes is a wasteful rent seeking activity, constituting a diversion of output and productive resources. Corrupt regulators defeat the purpose of regulation. The inability, by government, to credibly pre-commit to a policy regime can deter investment. Thus, a nation's institutional capital stock includes mechanisms that facilitate economic transactions and enforce contracts such as an accounting system and a legal system where disputes regarding contractual obligations can be settled. Traditionally, mainstream economists have taken institutional capital for granted, but the absence of the same in transitional economies of the former communist bloc provided a rude awakening as to its importance. The absence of a well functioning governance system and institutional capital may be said to generate greater *transaction* costs to economic activity, see Dixit (1996). In turn, higher transaction costs might explain part of the poor growth record of vulnerable economies following globalization.

Related to this are notions of social capital. A nation's institutional capital stock includes mechanisms that facilitate economic transactions, as mentioned above. This is sometimes described as public social capital. Other types of social capital include local networks of trust and understanding, described as civic social capital. These serve to lower the transactions costs of doing business, and have positive externalities on growth. Social capital, however, is not always positive or beneficial. Clear examples of the consequences of harmful social capital are the ethnic conflicts raging all over the world at present.

Campos and Nugent (1999) attempt to operationalize more amorphous notions of good governance. Although their paper lacks a properly specified theory, one can deduce that they are indicating at a 'production function' for good governance. This is a function of: (i) an accountable executive; (ii) an efficient civil service; (iii) the rule of law; (iv) participation by 'civil society' in policy making; and (v) an open and transparent policy making process. One can imagine other 'inputs' such as property rights and contract enforcement. Be that as it may, the authors construct a data set based on scaling coefficients for the first four characteristics, pertaining to various countries in East Asia and Latin America. This data is then related econometrically to three measures of human development: per capita income, infant mortality and adult (il)literacy. To summarize, the rule of law tends to be the most important institutional characteristic in explaining human development, particularly in Latin America. If East Asia is taken alone, the quality of the civil service is the most important factor. Furthermore, in Latin America the quality of the bureaucracy and the rule of law are often substitutes into the good-governance production function; whereas in East Asia it is strong civil society and the rule of law that are often the substitutable inputs. One of the more important policy conclusions that follows from this study is that institutional capital can be accumulated, and the stock altered, following appropriate political choices.

The analysis of corruption is always clouded by the failure to separate the efficiency and equity considerations that follow from the process of corruption. A succinct summary of the former can be found in Laffont (1999), and the literature cited therein. This includes an analysis of the circumstances where it might be beneficial to increase competition amongst corrupt officials provided that it does not encourage greater collusion amongst the corrupt. Asymmetrical corruption, say in a situation where bribes are not demanded across the board, can lead to the most Pareto inferior outcomes, as far as resource misallocation is concerned.

Unlike in the past, it is now widely believed that income inequality actually hampers growth prospects. One reason for this view is that a more egalitarian distribution of income promotes social harmony and leads to greater macroeconomic stability.[15] It is also said to contribute towards greater resilience to macroeconomic shocks, as the burden of adjustment appears to be shared more equitably. In addition to more equal income distributions countries with less internal strife, and better (less costly) conflict resolution mechanisms could enjoy higher growth rates as they are more peaceful. Costly internal conflict resolution mechanisms, which often take the form of competition for scarce resources by different groups, resemble a non-cooperative race to the bottom. In the context of sub-Saharan Africa, and also elsewhere, it is hard to deny the contribution of group inequalities, internal struggles and costly conflict resolution mechanisms towards growth retardation and retrogression.

4.4 Openness and growth

In their influential paper, Sachs and Warner (1995) stress the growth promoting aspects of openness. Openness implies less protectionism and the absence of a bias towards a more outward-looking economic development. On the face of it, a less than open policy regime will not be able to seize the opportunities presented by increased globalization. Sachs and Warner (1995) outline five indicators, the presence of any of which causes them to characterize an economy as closed: (i) average import tariff rates greater than 40 per cent, (ii) a non-tariff barrier coverage exceeding

[15] See Alesina and Rodrik (1994), Persson and Tabellini (1994). On the costs of internal conflict resolution see Rodrik (1998).

40 per cent of imports, (iii) a 'socialist' economic system, (iv) state control of major exports, and (v) a black market exchange rate premium over the official exchange rate greater than 20 per cent during the 1970s or 1980s. They conclude that economies that satisfy all requirements for openness will enjoy annual average growth rates two and a half percentage points over closed economies. Rodriguez and Rodrik (1999) review other studies of openness and its growth promoting potential.

Another important study on the marginalization of many developing countries, in the sphere of trade and investment flows, during the recent past is by Low *et al.* (1998). It is clear from the examination of trade patterns that the world trade share of many developing economies has fallen. Sub-Saharan Africa's share of world exports declined from 3.1 per cent during the 1950s to 1.2 per cent by 1990. The corresponding decline for Latin America was from 5.6 per cent to 4.9 per cent. On the other hand, between 1985 and 1996, Asia's share of world trade rose by 25 per cent. We have already noted above how concentrated are FDI inflows to developing countries. Given that world trade and FDI grow faster than world GDP, this is *prima facie* evidence that some countries, especially in Africa are marginalized from the increased globalization of recent times. Low *et al.* (1998), however, attribute the declining world trade share of the less successful economies to the pursuit of inward looking policies, echoing Sachs and Warner (1995). Their methodology employs several concentration ratios for shares of world trade, and size adjusted measures of openness. Puga and Venables (1999) consider trade policies in the presence of agglomeration economies. They conclude that a liberalized trade regime promotes industrialization and knowledge spillovers via cheaper intermediate goods imports that embody such knowledge. Their model utilizes Korean input-output coefficients to simulate numerical results. Interestingly, this model advocates openness, or at least an open trade regime; a similar type of model in Krugman and Venables (1995) presents bleaker prospects for some countries following an exogenous increase in 'world' openness, which we refer to as globalization. Thus, globalization clearly produces winners and losers as production becomes more concentrated in a more *integrated* world, but once this increased globalization has become an irreversible reality, endeavouring to remain relatively close may be the wrong strategy.

Many of the less successful economies in the developing world could be described as less than open, at least until recently. But it is equally true that many of the successful countries in terms of growth and industrialization have, albeit temporarily, pursued import substitution industrialization strategies. These protectionist policies were, however, eased off at the early stages of the present episode of globalization. Rodriguez and Rodrik (1999) state that: 'there has been a tendency in academic and policy discussions to greatly overstate the systematic evidence in favour of trade openness' (p. 63). They also argue that indicators of trade restrictions may be highly correlated to other factors that retard economic growth. Similarly, on the flip side of the coin, countries that grow faster might do so for reasons other than mere openness. In particular, they argue that the chain of causation lies between growth promoting productivity increases to success in exporting abroad, but not the other way around. In the final analysis an open trade regime may be a necessary condition for successful integration and participation in the globalized economy, but openness in itself is not sufficient to guarantee results.

4.5 Macroeconomic obstacles

Macroeconomic stabilization is important even if nations decide to avoid full participation in the globalized system. Sound anti-inflationary monetary policies, a movement towards fiscal balance and a stable exchange rate system are the corner stones of good macroeconomic management. If a developing economy is not well managed in these areas, it will have no recourse but to seek assistance from the IFIs, who will in turn demand macroeconomic reforms aimed at combating inflation, balancing the budget and stabilizing the exchange rate regime. There are, of course, good reasons, for pursuing these goals as part of a strategy for good economic management. A stable macroeconomic background is a pre-requisite for those countries that wish to successfully participate in the globalized economy.

The main policy issue in this regard is to do with the sequencing of macroeconomic reforms. There is recognition of the need for the optimal sequencing of policy reforms. In the presence of demand and supply shocks the implementation of reforms are subject to a degree of uncertainty. As Toye (1999) points out there are two broad sets of issues to be considered when carrying out macroeconomic reforms. The first is to do with the aggregate welfare gains from reform. The second is connected with the political economy effects of lobbying by interest groups that are affected by the reform process. With regard to the first point it is important to be aware of the policy trade-offs in implementing reform. For example, a programme of trade liberalization which lowers import duties and quotas might be removing distortions; but it has adverse short-term effects on revenues and hence the fiscal deficit. The optimal policy sequence would be to stabilize the budget deficit prior to trade liberalization. Similar arguments, with respect to reserves, would apply to policies of currency convertibility. Macroeconomic theorists are increasingly aware of the political economy or interest group implications of policy regimes and reforms. A programme of privatization may be resisted by labour unions, trade liberalization by disaffected industrialists, and certain governments may be constrained in their actions that affect strategic interest groups. Policymakers ignore these facts at their own peril.

In general, increased globalization attenuates the ability of national governments to pursue independent macroeconomic policy. This may be a mixed blessing, as governments cannot always be regarded as benevolent. Neither is the private international financial system to which small nations are increasingly hostage. Herding behaviour, financial contagion and volatile behaviour characterize world capital markets. Under these circumstances, financial liberalization can lead to increased financial fragility, see Demirgüç-Kunt and Detragiache (1999) on this. The idea is that as countries liberalize their banking sectors and currency markets they become more prone to banking and exchange rate crises. Therefore, this implies: (a) that nations should proceed with caution before liberalizing the financial sector, and (b) when they decide to do so in order to exploit the potential benefits of greater globalization, they should remain vigilant and monitor indicators that signal the onset of financial crises. The presence of a fragile banking sector makes the defence of the currency under speculative attack even more difficult. More often than not, twin (banking and currency) crises appear, and cumulative losses to GDP in any year can be substantial (about 15 per cent according to figures cited in Kaminsky 1998). There is sometimes a high degree of correlation between indicators of banking and currency crises, implying that some variables emitting danger signals in one area are also indicative of trouble in the other (see Kaminsky 1998 on this). Examples of these include money balances (M1, M2/Reserves of foreign currency, bank deposits).

A related issue concerns the prudential regulation of domestic financial markets. The importance of a well functioning financial system to the success of any economy, but especially one that is outward-oriented, cannot be overemphasized. This is because of the disproportionate externality that malfunctions in the financial sector have on the real side of the economy.[16] The major actors in the domestic financial system are the central bank, commercial banks and possibly a nascent stock market. There is a large literature on the importance of rules and a constitution to govern the conduct of the guardians of the financial system (see Dixit 1996 and the references therein). The avoidance of bank runs, loss of confidence in the financial sector and capital flight are also relevant monetary policy issues. As far as commercial banks are concerned there are important issues in their regulation related to the principal-agent literature, see Dewatripont and Tirole (1994) on this. There is considerable moral hazard on the part of bank managers as they perform multiple tasks, and are often accountable to multiple principals (the common agency problem). Furthermore, there are issues of adverse selection in the lending decisions undertaken by banks. With regard to stock markets there is the view that groups of small countries should cooperate to form a regional securities market, rather than struggle with small domestic stock exchanges.

5. INTERNATIONAL OBSTACLES TO SUCCESSFUL INTEGRATION

5.1 The WTO and vulnerable economies

First, there is the issue of membership of the WTO. Of the 48 countries making up the UN defined least developed countries only 29 are members of WTO, another 4 were in the process of accession, UNCTAD (1998). The question then arises will WTO membership enable these countries to participate meaningfully in the globalized system. The benefits, aside from the value of entering into orderly arrangements may be elusive. But there are several areas where they might be disadvantaged as non-members of WTO. Among these, are not benefiting from the *eventual* removal of the MFA (multi-fibre agreement) governing clothing and apparel exports from developing countries. Other examples include: not getting minimum market access opportunities in agricultural products are available for non-WTO members; and, perhaps most crucially, non-members cannot claim compensation for injuries sustained in anti-dumping and safeguard actions (such as voluntary export restrictions) imposed by importing countries.

[16] This has a long tradition going back to Keynes (1936). For more contemporary views, see Greenwald and Stiglitz (1993), for developing countries a succinct set of papers is contained in Rojas-Suarez (1997).

Secondly, at the operational level, many small developing countries are experiencing difficulties in meeting some of their complex WTO trade obligations. These problems include procedural notification obligations as well as implementing agreements. Skill shortages and lack of permanent missions have been cited as reasons for non-compliance with WTO treaties. UNCTAD (1998) points out many instances when developing countries are being bullied by developed countries into assuming obligations under the WTO agreements that go beyond their actual contractual commitments. Langhammer and Lücke (1999) point out that asymmetrical accession criterion is applied to different countries waiting to join the WTO. Sometimes the terms offered to them are more stringent than the rules applicable to some existing developing country members. Pressure is often brought to bear on developing countries not to fully utilize transitional periods of adjustment. Developed countries, however, are known to drag their feet over implementing measures that could be of benefit to developing countries, the phasing out of the MFA is the best example. Countries from the developing world that are newly acceding to the WTO are reportedly pressurized into unnecessary measures: for example on the agreement on government procurement and TRIPS (trade in intellectual property rights).

In order to facilitate the meaningful participation of developing countries in the WTO system, mechanisms need to be constructed to enable them to defend themselves against unilateral action by developed countries and help them fully participate in the agenda setting of the WTO. The former issue becomes most apparent when it comes to defending anti-dumping allegations initiated by developed nations. A proposal is under consideration that would set up a Legal Aid Centre for developing and transitional economies based upon each country's ability to pay and its share of world trade. Das (1999) points out how developing countries are side-stepped in the decision making, negotiation and agenda setting processes of the WTO. This occurs, despite the fact that the WTO operates on a one-member one-vote system. Developing countries seem unable to form coalitions among themselves for the purposes of trade negotiations. Many developing countries had unilaterally reduced their protective barriers towards goods from the developed North during the Uruguay round. This was in marked contrast to the pre-Uruguay round trade negotiations when it was the North that made non-reciprocated trade concessions. Clearly, the end of the Cold War has led to a significant diminution of the bargaining power of the South, accompanied by the ability of the North to dictate terms to the South.

Thirdly, at a more fundamental level, authors such as Bhagwati (1994) have indicated there is a growing concern in the North (particularly, the United States) for *fair* as opposed to free trade. This particularly depends very much on the USA's perception of fairness and what is in her interests. It also leads, as Nayyar (1996) points out, to an increasing *asymmetry* in the application of the principle of free trade when it comes to the rules governing North-South trade, see also Murshed (1992). This asymmetry is, however, absent in intra-Northern trading relationships. The old GATT system was concerned with multilateral rules governing trade. In contrast, the post-Uruguay trading framework is much wider in scope. The coverage has been widened to suit the USA and also the North in general. These include, *inter alia*: trade in services via GATS (general agreement on trade in services); the transfer of technology via rules governing domestic content requirements in TRIMs (trade-related investment measures); and, subsidies (subsidies for R&D and environment are permissible, but subsidies for industrial development, of possible benefit to vulnerable economies, are illegal). What it means is that free trade is permitted in areas where the North has a competitive advantage, but not necessarily when the South has a clear and perceived edge. For example, trade in clothing, footwear and labour-intensive services, are still regulated by the remnants of the MFA. The North is being extremely slow in honouring its commitment to the eventual abolition of this arrangement, which gives authorities in the North the right to negotiate clothing exports from the South on a case-by-case basis. For example, the provision of labour intensive services by countries in the South, which would require emigration from North to the South, is strictly regulated and at the discretion of national governments in the North. But on the other hand, multilateral arrangements and rules (not discretion by governments in the South) govern the activities of the North's (mainly American) transnational corporations, via TRIPs and TRIMs, in the South. All in all free and unfettered trade is permitted when it suits the USA and the EU, but not when it is beneficial to the South.

Fourthly, we come to various items that are being placed into the WTO high level agenda such as the environment, investment, competition policy and government procurement policies that are inimical to developing country interests. At last, it is being resisted by some of the larger and more powerful nations in the South (BRIDGES 1999). Other ongoing arrangements whose renewal are to be discussed include TRIPs and electronic commerce, see Das (1999) for more detail.

Some of the least developed countries continue, in principle, to enjoy special and differential status in their trade with developed countries, as do ACP nations in the case of EU markets. Of concern to many small vulnerable economies is the potential loss of export revenue and its consequences for national income of disputes like the 'banana war' being waged between the USA and the EU. In summary small developing economies are disadvantaged by present day world trading arrangements in two fundamental senses: (a) the danger that free market access to the North may suddenly be curtailed when it suits countries in the North, and (b) the transfer of technology is considerably more expensive and difficult given the presence of the US sponsored TRIPs arrangement. Other concerns centering on labour and environmental standards are discussed in section 5.3 below.

5.2 North-South trade and labour markets in the North

The shift of competitive advantage in labour intensive manufacturing production from North to the South has attracted a good deal of attention from commentators in developed countries. This is motivated by either rising unemployment or a fall in the wages of the unskilled group of the North's manufacturing labour force, the blue-collar worker. This phenomenon is said to have sparked off major social unrest in the North, as well as promoting increased inequality in income, wealth and opportunity. More often than not, protection from the insidious sources of the competition driving these processes is demanded. The culprit is usually identified to be the relatively poorer countries in the developing world or South; where it is stressed that low wages and generally exploitable conditions have led to the wholesale movement of certain manufacturing activities. Free trade with the South should be eschewed as it pauperizes unskilled labour in the North, as well as being detrimental to human rights, labour standards and the environment. Indeed, much of the South's exports to the North is already heavily subject to protectionist measures (see Page 1994). Also, Krugman (1994) cites the calls made in certain quarters for all trade to be regulated along the lines of the Multi-Fibre Agreement, which assigns strict quotas to the textile and apparel exports of developing nations to industrialized countries. Such protectionist calls, and the managed trade measures already in place, constitute a very grave threat to the meaningful participation of developing countries in the international system.

There has been a secular trend towards a decline in manufacturing employment, as a share of total employment, in most of the advanced industrialized nations. More recently, there has been a tendency for *wages* to decline in the USA and *employment* to fall in the Western European segment of the North (OECD). In the USA and the UK there has been an increase in wage dispersion. In other words, the earnings differential between the skilled and unskilled has widened (Lawrence and Slaughter 1993). The skilled are often classified as non-production workers in empirical studies, and the unskilled are categorized as blue-collar production workers, but generally includes all workers with only the most basic education and training, irrespective of whether they are in manufacturing or the service sector. Consider the Heckscher-Ohlin-Samuelson paradigm of international trade. The North is more abundantly endowed with skilled labour compared to the South; hence it exports skill intensive goods to the South, importing unskilled intensive goods. An increase in trade with the South will therefore raise that region's exports of unskilled labour intensive manufactured products. In labour markets characterized by institutional rigidities, as in Western Europe, and in the presence of specific factors, as well as inter-sectoral labour immobility of unskilled labour, unemployment could rise in the North. Alternatively, in more flexible labour markets, common in the USA and the UK, the relative wage of the unskilled would fall. According to the Stolper-Samuelson theorem, the real wage of unskilled manufacturing workers in the North relative to the skilled will decline if and only if the relative price of unskilled labour intensive manufactured goods fall. Thus, if there is empirical proof that the relative price of unskilled labour intensive manufactured imports declined relative to skilled labour intensive export prices (for the USA say); then and only then is there evidence of trade related disadvantaging of unskilled labour.

The empirical evidence on the contribution of the Stolper-Samuelson process towards the lowering of the unskilled manufacturing relative wage in the USA is the subject of some controversy. Lawrence and Slaughter (1993) show that the relative price of unskilled labour intensive manufactured goods actually rose in the 1980s, compared to skill intensive manufactures such as computers, whose prices fell reflecting technical progress in those industries. This is disputed by Sachs and Shatz (1994); who use a different data set, oddly excluding computers, and find that the contribution of trade towards the lowering of unskilled wages was slight. Irrespective of the direction of change in the relative price of unskilled to skilled labour intensive manufactured goods, the causal nexus between trade with the South and the impoverishment of unskilled workers in the North can be dismissed if there is technical progress favouring the skilled. In other words, if technical progress is of the type that raises the productivity of the skilled group, it will increase their wages relative to the unskilled. Lawrence and Slaughter (1993) find considerable support for the view that labour augmenting technical progress did lower the relative real wage of the unskilled in the USA (defined as non-agricultural production workers). In fact, they find that technical change in manufacturing was biased towards skilled labour (non-production workers) and more concentrated in activities using more skilled labour (computers, for example). The effect of this bias is that technical progress benefits the skilled in terms of wages and employment, and could actually disadvantage the unskilled. Thus, according to these and other authors, the relative decline in the real compensation of unskilled manufacturing labour in the USA is explained mainly by biased technical progress raising the productivity of the skilled. Labour market imperfections in the North and real wage rigidity could cause unskilled wages in the North to become too high. This may lead to the relocation of unskilled labour intensive manufactures to the South and induce labour saving technical progress. This point has received scant attention in the mainstream literature.

5.3 Environmental and labour standards in North-South trade

We have already noted above that the environment is becoming part of the agenda in WTO negotiations. The incorporation of labour standards into the exports of the South is also being discussed. Environmental and labour standards imply that products exported from the South should be produced without jeopardizing the environment; and retaining minimum respect for the rights of labour producing these goods. The standards in themselves can be highly subjective; their imposition is tantamount to utilizing trade restrictions for the realization of non-economic objectives (environment and human rights). Irrespective of whether they are well intentioned or misguided; the subjective environmental and labour standard preferences of consumers or consumer groups in the North are exactly that, preferences. Neoclassical economics states that consumer preferences should be reflected in a willingness to pay, higher prices, in this instance, for environmental and human rights content. But there is the danger that protectionist interests could manipulate altruistic motivation. The prominent trade theorist T. N. Srinivasan has said: 'The real danger of using trade sanctions as an instrument for promoting basic rights is that the trade-standards link could become hijacked by protectionist interests attempting to preserve activities rendered uncompetitive by cheaper imports'.[17] One can imagine the following statement on the lips of a lobbyist for US garment industries: 'do not purchase this T-shirt made in Asia, it is produced in sweated labour conditions'. From the point of view of developing countries, particularly the more vulnerable ones, there is the potential danger that compliance with some of these standards could render their goods uncompetitive in international markets. It has also to be borne in mind that many of these countries are struggling to keep up their exports to the North so as to honour their debt-servicing payments to the North.

Yet the maintenance of some of these standards could be to the benefit of all. It is worthwhile recalling that much of agriculture in the North (heavily subsidized by the taxpayer) is often guilty of surreptitiously unfriendly acts towards the environment. The control of certain types of exports via temporary bans can be of some value in promoting sustainability and long-term productive capacity. For example, shrimp farming for export in Bangladesh was leading to the salination of arable land and the destruction of mangrove forests, all of which is against the long-term interests of Bangladesh. Also adherence to certain standards should not make exports from developing countries uncompetitive given their huge cost advantages. Concern for the environment can also lead to exports of new products and services, Eco-tourism for example. Above all, there is the need to safeguard environmental capital and utilize this resource in a sustainable manner. Considerable difficulties exist in arriving at mutually agreeable definitions, by different parties in this area. Potential benefits can arise if consumers are not misled, environmental standards are not imposed by *fiat* via the WTO, and above all do not fall into the hands of protectionists. Smaller developing economies in coalition with larger economies, should link concerns about environmental standards to pledges made by the North to aid the South in the abatement of pollution. More economic analysis needs to be conducted on the short-term effects of more sustainable production and trade on the welfare of producers and consumers in both the North and the South (see, for example Page 1999).

Labour standards in developing country exports can be more controversial. They relate to human rights, and these can be relative values. A worker in a developing country 'sweat-shop' could be working under conditions unacceptable by Western standards, but may be better off than in the

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17 In the World Bank (1995), *World Development Report*, p. 79; cited by Freeman (1998).

alternative scenario. Even when there is universal acceptance of absolute standards regarding the rights of workers, the method of implementing them can be hotly debated. A good example of this concerns the issue of child labour. Most people would be opposed to the existence of child labour (appropriately defined). How is this noble goal best implemented? By banning the import of goods utilizing child labour (such as carpets and footballs) at the level of Trade Ministries in developed countries and multilateral fora such as the WTO? Might it be preferable to tackle the root of the problem, via poverty alleviation in developing countries? Then there are intermediate positions: even if child labour is allowed to continue, there should be adequate safeguards such as schooling and minimally decent living conditions.

In a recent paper, Freeman (1998) argues that there is evidence to suggest that the median consumer in the North has altruism built into their utility functions, and are prepared to pay for more humane conditions for workers as well as the abolition of child labour. He also argues that the implementation of standards, when they do raise labour costs in exporting countries, could accrue to as long as the demand for labour with respect to wages is inelastic. The actual running of international labour standards would, necessarily, require monitoring. There are huge problems of moral hazard, adverse selection and regulatory capture associated with monitoring that Freeman (1998) does not explicitly consider. He does, however, suggest a range of monitoring mechanisms, which he argues should operate simultaneously. These range from labelling (such as rugmark), corporate codes of conduct, to monitoring/advocacy activities by NGOs, governments and international agencies. As with environmental standards, the working of labour standards may be potentially Pareto improving. But a great deal of care needs to be exercised in balancing different interests, including the macroeconomic objectives of developing countries. Otherwise the best intentions could, like faith without charity, come to nothing.

6. CONCLUSIONS AND POLICY IMPLICATIONS

There are a variety of conclusions and policy implications that can be derived from the study of the experience of vulnerable and marginalized economies in the globalization process. If these nations are to move forward a mixture of policies and reforms need to be adopted, both at the domestic and international levels.

When it comes to the successful integration of developing economies into the globalized system the experience of very small economies (in terms of population) or micro-states can be of relevance. Many of these states are small islands in the South Pacific and the Caribbean and are extremely vulnerable to shocks. This has led to the construction of several types of vulnerability indices (see the references in Armstrong and Read, 1998). Some of these countries have performed relatively well, at least in the policy arena. The greatest advantage they enjoy, in the context of our present phase of globalization, is that their small size has always forced them to be very open, even in the days when the world economy was relatively less open. The fact that they have had very limited policy sovereignty may have precluded many serious strategic errors, both in the realm of macroeconomics as well as industrial policy. By tying their hands to another currency they have often avoided serious exchange rate misalignments and some forms of inflation. By not enjoying the luxury of a protected domestic manufacturing sector they have avoided the pitfalls of many associated policy distortions.

Clearly an important objective is to increase the involvement of vulnerable economies in international trade. Here lessons can be drawn from successful exporting economies in the developing world. Mere trade liberalization is insufficient. In the case of Chile, Agosin (1997) points out that sensible monetary policies were pursued to prevent real exchange rate overvaluation. Supply side reforms eventually led to technological innovations and export diversification away from traditional staples. Another successful exporter in the Latin American and Caribbean region has been Costa Rica, see Rodriguez (1998). It diversified its export base following the debt crisis of the 1980s. Exports of traditional goods to regional markets were increased, tourism expanded, and lately Costa Rica has become a major producer of microchips. It has thus, successfully moved up the value chain into technologically/skilled labour intensive exports. East Asian economies have been particularly successful in this respect, and in the expansion of intra-regional trade. There may be a fallacy of composition argument in operation; every country cannot simultaneously expand exports on to the world market. If, however, nothing is done, nothing will change. The removal of supply-side bottlenecks are perhaps the most important policy undertaking: these include the development of infrastructure, know-how (marketing included) and the governance structure.

The trading rules that exist in the present day globalized environment do place constraints and extra costs in any strategy of technology diffusion and development. These extra costs engendered by post-Uruguay round arrangements such as TRIPs curtail the ability of emulating the industrial strategies, which were pursued by the Asian NICs. Powerful interests in the North often substitute principles of free trade for managed trade whenever the South threatens to take up substantial market share. WTO negotiations are therefore, crucial. Small economies need to form coalitions in these negotiations to look after their interests. Technical assistance should be provided, to enable vulnerable economies deal with the increasingly complex and arcane arena of WTO negotiations and compliance.

Harnessing finance for development is also a major policy objective. The fact that vulnerable economies receive very little FDI has already been noted. This is because most of these nations are perceived as high risk economies with poor infrastructure that will not allow FDI to be absorbed. In the recent past, however, there has been a promising growth in intra-South FDI and venture capital participation motivated by regional trade, particularly in Asia. UNCTAD (1998) stresses the importance of having investment insurance to encourage financial flows to the least developing economies. International organizations and bilateral donors, particularly the Washington based institutions, can do a lot to inspire confidence in developing economies and foster financial flows. This is all the more important in the light of recent financial crises and the spread of financial contagion from one country or region to another. Attention also needs to be given to alternatives to the more traditional forms of international finance, which involve bank lending and FDI. Portfolio investment and venture capital funds are two other options, although the first is susceptible to the vagaries of financial crises.

Most developing countries have already undertaken macroeconomic reforms and substantially liberalized their trade policies. Supply-side reform has been less widespread. It can be argued that some of the policy reforms have been conducted in a piecemeal fashion, and that there is the danger of retrogression. Thus, it is all the more important that the reform process is properly sequenced particularly when uncertainties are present. A stable background is necessary for successful and lasting reforms. It is, therefore, important that stabilization of the macroeconomy should precede liberalization of trade and financial policies. The importance of sound and prudential regulation of banks and stock markets is crucial for sustainable development and growth as indicated above. It is of additional significance if the possible spread of financial crises is to be avoided. Without improvements in the governance structure and the accumulation of institutional capital any reform process or growth strategy in a globalized context will be doomed to failure. This is, arguably, the most important lesson of the last half of the century in development policy.

Vulnerable economies have become caught up in the wave of accelerated globalization sweeping through the world in the last two decades. Besides being intrinsically vulnerable, they face new constraints in the processes of trade, technology transfer, investment and international finance. Economic policy making powers of the nation state are considerably less in the present globalized context, this at least places greater restraints on the world's more non-altruistic governments. But societies and states do retain some residual room for manoeuvre over the pace at which they embrace the full implications of globalization. Thus, choices should be wisely exercised, and capacities built up before rushing into the globalized world.

Besides humanitarian reasons, they are compelling security considerations as to why the affluent world should be concerned with the development of the really disadvantaged and marginalized countries of the world. Otherwise the dangers of wars and localised conflicts loom large, which in the end affect everyone. There is also the dreaded threat of mass immigration from poor countries to consider. It has also to be remembered that the poorer countries of today could in future constitute an important source of demand for the global economic system, and therefore should not be completely cast aside at present.

Debt relief for the poorest countries, agreed upon at the G-8 Cologne summit in June 1999, is a small but welcome beginning towards addressing their problems. Since the incomes of many vulnerable economies fluctuate considerably in response to external and supply shocks the utilization of some form of insurance funds might be useful cushion these variations, and enable the reform process to proceed (see Cornia 1997a on these and other social fund ideas). Bloom and Sachs (1998), among others, advocate the use of the scientific expertise of the world to solve some of the most pressing problems in the disadvantaged regions of the globe. The pride of place in such a drive has to go towards conquering tropical diseases such as malaria, as well as making affordable aids vaccines available to the poor, Sachs (1999). Then there is the matter of engineering a green revolution, this time for Africa. Above all, there is the global environment. Climatic change, caused mainly by emissions from the affluent world, have contributed to desertification in the Sahel, and lowered agricultural productivity in the tropics, while ironically increasing productivity in many affluent temperate zones. The North owes the South an environmental or natural debt, due to its past emission history. The problem with all of these issues is that the resources required to resolve them will not be forthcoming from the private sector because they suffer from the 'public goods' problem, that is the private sector finds it unprofitable to supply these goods and services. Therefore, concerted public action at the global level is needed.

There are encouraging signs that the world is moving away from the simple minded version of the Washington consensus which advocated liberalization and privatization as panaceas for all the world's economic problems. The need for global consensus remains, and the institutions of democratic dialogue have to be strengthened. This must be achieved, if progress is to be made towards sharing costs for global public goods in an equitable and acceptable fashion to all. It is also necessary to thwart the movement of global public 'bads' such as drug trafficking, the illegal arms trade and money laundering (UNDP 1999). For such a democratic consensus to emerge greater use has to be made of truly representative international institutions, such as the UN. There is an unfortunate tendency following the end of the Cold War, as only one superpower remains on the map, for important international decision making to take place in *ad hoc* and unrepresentative fora such as the G-8, G-10 and so on.

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