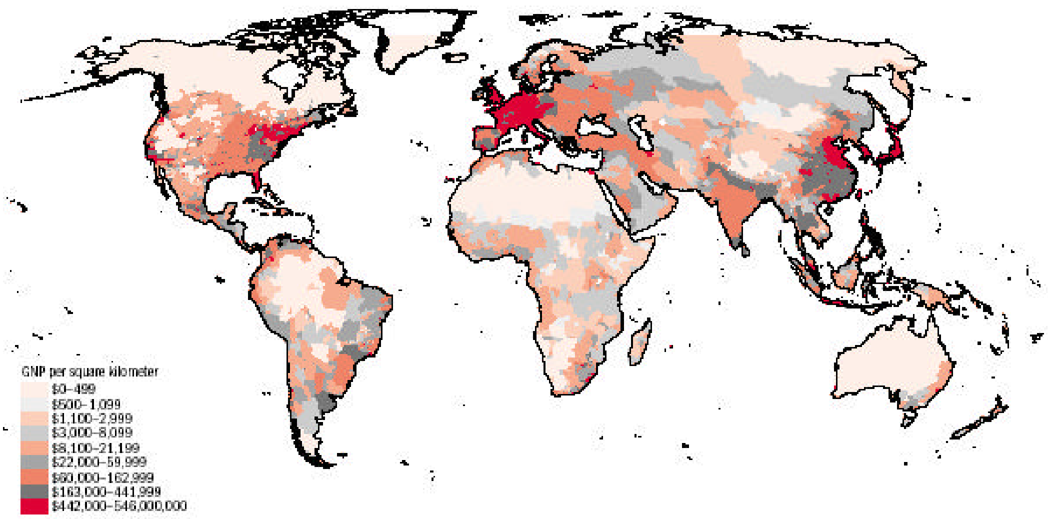
IBI - Institute of Brazilian Issues

Minerva - Spring 2004

Openness And Development: A General Analysis and a Close Look at China, Argentina and Brazil



Source: Sachs, Mellinger, and Gallup (2001).

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April, 2004

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1. Introduction

Economic theory states that protectionism prevents the efficient allocation of resources via market forces and foreign competition, which stifle the private sector by restriction, leading to oligopolistic and uncompetitive practices, inefficiency, misallocation of resources and corruption. However, in practice some undesirable consequences of trade liberalization have taken place in South Korea, Russia, Turkey, Argentina, and other countries. At the same time, countries like Mexico, Chile, China, India, Bangladesh, Vietnam, Marocco, Canada, the U.S., the EEC nations have experienced positive results from liberalization. So, my work will aim at finding what is behind these results, why some countries prosper and others do not.

It is an empirical fact that the income gap between poor and rich countries has increased in recent decades. Only a handful of developing countries, mainly from East Asia, have been able to grow out of poverty so far, although a second tier of developing, least-developed and transition economies have made rapid progress in more recent years, including countries as diverse as China, India, Vietnam and Uganda.

2. The Waves of Globalization

Historically, we have had three waves of the so-called globalization (that is, the movement of people, capital stock, and goods and services across countries). Before 1870, none of these variables were sufficiently large to warrant the term globalization.
The first wave of globalization happened roughly from 1870 to 1914. The export of land-intensive primary commodities in exchange for manufactured goods from industrialized countries represented the pattern of trade during this period. This trend of more integrated countries was reversed between 1914 and 1945, when nationalism was widespread. After 1945, there was a period where protectionism reined, but as trade barriers came down,

and transport costs continued to fall, trade revived. This second wave of globalization, which lasted until around 1980, was approximately a return to the pattern of the first wave.

Since 1980, a new pattern has been set into place. Many developing countries have broken into world markets for manufactured goods and services, which nowadays account for 80% of their exports, up from 25% in 1980. There has also been a substantial increase in FDI. There is now an important change: low-income countries are now competing head-on with high-income countries while previously they specialized in primary commodities. This new wave of global market integration, where world trade has grown massively, is called the third wave of globalization. So the period of international integration we are now experiencing is different from the first two waves. Many poor countries are now exporting mainly manufactured goods, instead of primary commodities.

2.1 The First Wave of Globalization (1870-1914)

The first wave was triggered by a combination of falling transport costs, such as the switch from sail to steamships, and reductions in tariff barriers, pioneered by an Anglo-French agreement. Cheaper transport and the lifting of man-made barriers opened up the possibility of using abundant land. New technologies such as railways created huge opportunities for land-intensive commodity exports. The resulting pattern of trade was that land-intensive primary commodities were exchanged for manufactures. Exports as a share of world income nearly doubled to about 8 percent.

Since land was abundant in the newly settled areas and given the fact that the production of primary commodities required people, about six million people migrated from Europe to North America and Australia. Including South-South labor flows, the total labor flow during the first wave of globalization nearly reached 10 % of the world population.

Large amounts of capital were also needed to produce primary goods. So large flows of capital, mainly from Great Britain, were channeled abroad. By 1914, the foreign capital stock of developing countries had risen to 32 percent of their income, up from 9% in 1870.

Globally, growth accelerated sharply. Per capita incomes, which had risen by 0.5% per year in the previous 50 years, rose by an annual average of 1.3 percent. Did this lead to more or less equality? The countries that participated in it often took off economically, both the exporters of manufactures, people and capital, and the importers. Argentina, Australia, New Zealand, and the United States became among the richest countries in the world by exporting primary commodities while importing people, institutions, and capital. All these countries left the rest of the world behind.

Despite the fact that world income inequality increased during the first wave of globalization (although at a lower rate than in the 50 previous years, 1820-70), among the globalizing countries themselves there was convergence. Mass migration was a major force equalizing incomes between them. "Emigration is estimated to have raised Irish wages by 32 percent, Italian by 28 percent and Norwegian by 10 percent. Immigration is estimated to have lowered Argentine wages by 22 percent, Australian by 15 percent, Canadian by 16 percent and American by 8 percent. "Indeed, migration was probably more important than either trade or capital movements (Lindert an Williamsom 2001b).

The impact of globalization on inequality within countries depended in part on the ownership of land. Where land ownership was concentrated, as in Latin America, increased trade was associated with increased inequality. Where land was more equally owned, as in West Africa, the benefits of trade were spread more equally. In Europe, conversely, globalization ruined landlords, for there was a dramatic fall in the price of their commodities.

2.2 The Second Wave of Globalization (1945-1980)

After a retreat on trade between 1914 and 1945, when protectionism became widespread, the world became again more integrated. During this period of retreat into nationalism, despite the fact that there was a great reduction of costs of transportation (sea freight costs fell to a third), exports as a share of world income were down to only 5 percent in 1950, roughly the same as back in 1870. At the same time, the foreign capital stock of developing countries was reduced to just 4 percent of income, far below even the modest level of 1870. Migration, too, decreased substantially on face of anti-immigrant sentiment and consequent government restrictions on newcomers. This isolationism did not cause world income inequality to decrease, but it had an adverse impact on the economic rhythm of growth, making income growth fall by a third.

In the period from 1945 to 1980, the previous retreat into nationalism gave an impetus to internationalism. The second wave of globalization then took place. The same sentiments that led to the founding of the United Nations persuaded governments to cooperate to reduce the trade barriers they had previously erected.

The nature of trade during this period, despite not being very favorable to developing countries, was extremely advantageous for developed countries. Broadly, by 1980, trade between developed countries in manufactured goods had been substantially freed of barriers, but barriers facing developing countries had been substantially removed only for those primary commodities that did not compete with agriculture in the developed countries. For agriculture and manufactures, developing countries erected barriers against each other and against developed countries.

Overall, trade doubled relative to world income, approximately recovering the level it had reached during the first wave of globalization. This result was greatly helped by the sharp fall in transport costs, with sea freight charges falling by a third between 1950 and the late 1970s. However, the liberalization of this period albeit restoring the North-South pattern of trade for developing countries – the exchange of manufactures for land-intensive primary commodities – did not manage to restore the international movements of capital and labor.

By contrast, for rich countries the second wave of globalization was spectacular. The lifting of barriers between them greatly expanded the exchange of manufactures. For the first time, international specialization within manufacturing became important, allowing for agglomeration and scale economies to be realized. This helped to drive up the incomes of the rich countries relative to the rest.

Rich country specialization in manufacturing allowed for the appearance of economies of agglomeration, which brought about gains in productivity from agglomerated clusters. This new production system developed in rich trading countries was responsible for high per capita income growth in them. At the same time, developing countries were left out of this system, due to the combination of persistent trade barriers in developed countries, and poor investment climates and anti-trade policies in developing countries, which confined them to dependence on primary commodities. As a result, despite the fact that developing countries experienced per capita income growth during this period, this growth was substantially slower than in the rich economies. As a group, developing countries were being left behind by developed countries.

The second wave of globalization was capable of bringing about more equity both among developed countries and within them. This could be achieved by mutual gains with trade experienced both between and within these countries. Relocation of cluster firms within these countries helped the movement towards equalization of income inside their borders. Inequality was reduced within rich countries in this period as a result of the growth, and policies for redistribution and social protection within developed societies.

2.3 The Third Wave of Globalization (1980-Present)

The new wave of globalization, which began around 1980, is distinctive. First, and most spectacularly, a large group of developing countries broke into global markets. Second, other developing countries became increasingly marginalized in the world economy and suffered declining incomes and rising poverty. Third, international migration and capital movements, which were negligible during second wave globalization, have again become substantial.

However, this recent world capital integration has brought about a new phenomenon: in the 1990's, the first capital account crises occurred in Mexico, 1994, then in Asia, 1997, Russia, 1998, Brazil, 1999 and Argentina, 2001-2002. Since the IMF was created and prepared only to face current account crises, these crises of new nature have reached undesirable dimensions, which had far-reaching direct adverse effects in several economies around the world. There is suspicion that even the United States' economy has been hit by these recent capital account crises.

Three fundamental factors have affected the process of economic globalization and are likely to continue driving it in the future. First, improvements in the technology of transportation and communication have reduced the costs of transporting goods, services, and factors of production and of communicating economically useful knowledge and technology. Second, the tastes of individuals and societies have generally, but not universally, favored taking advantage of the opportunities provided by declining costs of transportation and communication through increasing economic integration. Third, public policies have significantly influenced the character and pace of economic integration, although not always in the direction of increasing economic integration. These three fundamental factors have influenced the pattern and pace of economic integration in all of its important dimensions: through human migration; through trade of goods and services; and through movements of capital and integration of financial markets.

The most encouraging development in third wave globalization is that some developing countries, accounting for about 3 billion people, have succeeded for the first time in harnessing their labor abundance to give them a competitive advantage in labor-intensive manufactures and services. In 1980, only 25 percent of the exports of developing countries were manufactures; by 1998 this had risen to 80 percent. Furthermore, developing countries exports are indeed now labor-intensive.

This is an astonishing transformation over a very short period. The developing countries that have shifted into manufactures trade are quite diverse. Relatively low-income countries such as China, Bangladesh, and Sri Lanka have manufactures shares in their exports that are above the world average of 81 percent. Others, such as India, Turkey, Morocco, and Indonesia, have shares that are nearly as high as the world average. Another important change in the pattern of developing country exports has been their substantial increase in exports of services. In the early 1980s, commercial services made up 17 percent of the exports of rich countries but only 9 percent of the exports of developing countries. During the third wave of globalization the share of services in rich country exports increased slightly, to 20 percent, but for developing countries the share almost doubled to 17 percent.

This shift was partly due to changing economic policy tariffs on manufactured goods in developed countries, as they continued to decline, and also many developing countries undertook major trade liberalizations. At the same time, many countries liberalized barriers to foreign investment and improved other aspects of their investment climate. Partly it was due to continuing technical progress in transport and communications. Containerization and airfreight brought a considerable speeding up of shipping, allowing countries to participate in international production networks. New information and communications technologies mean it is easier to manage and control geographically dispersed supply chains. And information based activities are "weightless" so their inputs and outputs (digitized information) can be shipped at virtually no cost.

New technologies have not, however, led to the "death of distance." For most countries, distance has become even more important, mainly due to proximity requirements of "just-in time" technologies. The OECD agglomerations continue to have massive cost advantages and technological change may even be increasing these advantages. Even within well-located countries there will be clustering as long as agglomeration economies are important, and hence wage pressure to migrate to towns and cities. For countries such as China and India we can expect to see more migration toward coastal areas as development proceeds.

By the end of the millennium, economic activity was highly concentrated geographically. This reflects differences in policies across countries, natural geographic advantages and disadvantages, and agglomeration and scale economy effects. Africa, despite having a low GDP density, has a great potential to develop a number of successful manufacturing/service agglomerations, but if its development is like that of any other large region, there will be several such locations around the continent and a need for labor to migrate to those places.

The newly globalizing developing countries helped their firms to break into industrial markets by improving the complementary infrastructure, skills and institutions that modern production needs. So, to some extent those developing countries that broke into world markets just happened to be well located, and to some extent they shaped events by their own actions. As a result, the top third developing countries more globalized (greatest ratio trade/GDP) managed to increase trade relative to income by 104% since 1980, compared to an increase of 71 percent of rich countries. The remaining two-thirds of developing countries have actually had a decline in trade to GDP.

During third wave globalization, the new globalizers, which comprised mainly poorer developing countries in 1980, cut import tariffs significantly, 34 percent points on average, compared to 11 points for the countries that are less globalized. The more globalized today also has better property rights and rule of law. Besides trade reform, post-1980 globalizers such as Argentina, China, Hungary, India, Malaysia, the Philippines, and Thailand, undertook important reforms involving investment liberalization, stabilization, and property rights. The outcome of increased integration into the world economy need not be due to changes in trade policy. A reliable property rights system, strong rule of law, and macroeconomic stability are all associated with more trade and FDI.

As they reformed and integrated with the world market, the more globalized developing countries started to grow rapidly, accelerating steadily from 2.9 in the 1970s to 5 percent through the 1990s. They found themselves in a virtuous circle of rising growth and rising penetration of world markets It seems likely that growth and trade reinforced each other, and that the policies of educational expansion, reduced trade barriers, and strategic sectoral reforms reinforced both growth and trade.

Since 1980 the global integration of markets in merchandise has enabled those developing countries with reasonable locations, policies, institutions, and infrastructure to harness their abundant labor to give themselves a competitive advantage in some manufactures and services. The initial advantage provided by cheap labor has sometimes triggered a virtuous circle of other benefits from trade.

The weak globalizers, whose population accounts for about 2 billion people, have grown slower during the third wave of globalization than during the second. One reason is that many countries dependent on primary commodities suffered declining prices for their exports. For several reasons, these countries have not integrated into the global industrial economy: geographic disadvantage, poor economic policies (lack of investment in infrastructure, education, etc), political instability, etc. However, if some African countries adopt the right policies for integration (economic and political stability, rule of law, stable regulatory framework, investment in education, infrastructure, etc), they should be able to competitively industrialize themselves and successfully integrate into the world economy. Economies of agglomeration should arise as people migrate to best located cities, which should provide for international competitiveness in the production of manufactures and services. It is unlikely though that some landlocked countries in Africa will be able to get integrated successfully in the global market, for high transport costs make it difficult to compete in the global market.

In what concerns international capital flows, there has been a great increase since 1980. The main reason was that developed countries have ever since removed controls on capital outflows. At the same time, governments in developing countries have adopted less hostile policies toward foreign investors.

Total capital flows to developing countries went from less than $28 billion in the 1970s to about $306 billion in 1997. What was most impressive was the composition change of these flows. Official aid flows were halved, while private capital flows became the main source of capital for a number of emerging markets. At the same time, bank loans, which were the main source of foreign capital inflow to emerging markets in the 1970s up to the beginning of the 1980s, have lost their importance. FDI, on the other hand, grew continuously throughout the 1990s to become the main source of foreign financing for developing countries (privatization of public companies played an important role on this result). Net portofolio flows grew from $ 0.01 billion in 1970 to $103 billion in 1996, in real terms. New international mutual funds and pension funds helped to channel the equity flows to developing countries.

Even with this spectacular increase in capital flows to developing countries during the third wave of globalization, in terms of percentage of GDP (22 %, in 1998), capital flows remained more modest than during the first wave (32 %, in 1914). This number is, however, double of what it was in the mid-1970s (11%). The top 12 emerging markets though are receiving the overwhelming majority of the net inflows. These are countries such as Argentina, Brazil, China, India, Malaysia, Mexico, and Thailand.

FDI brings not just capital, but also advanced technology and access to international markets. It is critical for participating in international production networks. Dollar and Kraay (2001) find that FDI has a powerful growth effect, whereas the overall level of investment by itself does not have a significant effect on growth, other factors are more important.

Capital flows to developing countries, though, are just a tiny proportion of the global capital market. Because capital owners are concerned about risk, most global capital flows are between developed countries. Even the developing countries that have the highest FDI per capita, Chile and Malaysia ($2,000) have less FDI per capita than any of the of the developed countries. The United States, for example, has a FDI per capita stock of $3,200. However, in relative terms, as a percentage of GDP, developing countries have a higher chunk of FDI than the rich nations.

In what concerns migration, despite the massive gaps in income that had been built up by the end of globalization's second wave, only 2% of the world population live in a country other than that of their citizenship nowadays. That number was 10 percent during the first wave of globalization. However, since half of immigrants live in developed countries, and these countries' population is just one sixth of that of developing countries, 6 percent of rich countries' population is comprised by migrants. On the other hand, migrants comprise 1 percent of the population of poor countries.

The main economic rationale for migration is that wages for the same skills differ vastly in different locations, especially between developing countries and rich ones. The average hourly labor compensation in manufacturing is about $30 per hour in Germany, and one one-hundredth of that level (30 cents) in China and India. That gap is particularly extreme, but even between the United States and newly industrialized countries such as Thailand or Malaysia the compensation gap is ten-fold. Skill differences can explain only a small amount of the wage differential.

These large wage differentials should lead to mounting waves of migration. However, entry restrictions, which were erected mainly after 1914, have hampered migration to a certain extent. However, for example, since emigration from Mexico into the United States has been less restricted, there are 10 million Mexicans (10 percent of Mexico's population) living in the United States (7 million legal, and 3 million undocumented workers). Emigration on this scale has substantial effect on developing countries' labor markets. It is likely that emigration from Mexico has substantially raised Mexican wages.

The benefits of migration to the sending region go beyond the higher wages for those who remain behind. Migrants send a large volume of remittances back to relatives and this is an important source of capital inflows. India receives six times as much in remittances from its workers overseas every year as it gets in foreign aid. Furthermore, much trade and investment depends upon personal and family networks. For example, the Chinese migrants to other Asian countries play a significant role in trade and investment between these countries and China. The point is that migration can facilitate the other flows of globalization- trade, capital, and ideas.

Concerning the effects of third wave globalization on income distribution and poverty, the breakthrough of developing countries into global markets for manufactures and services, and the re-emergence of migration and capital flows, have affected poverty and the distribution of income between and within countries. Domestic policy choices unrelated to globalization also affect income distribution.

Among developed countries, globalization has continued to generate the convergence of the first and second waves. By 1995, inequality between countries was less than half what it had been in 1960 and substantially less than it had been in 1980. However, within individual countries, inequality increased in the third wave of globalization, reversing the trend seen during the second wave. A part of this may have been due to immigration. However, it may also have been due to taxation and social spending unconnected to globalization. Global economic integration is consistent with wide differences in domestic distributional policies: inequality within individual countries differs massively between equally globalized economies. For the OECD economies taken as whole, globalization has probably been equalizing as inequality between countries has radically decreased.

Among the new globalizers the same pattern of convergence has been evident as has occurred among the OECE economies over a longer period This seems to be indeed a general phenomenon among open economies. Treating the OECD and the new globalizers as a common group of integrated economies, overall inequality has declined.

As in the OECD countries, within-country inequality has increased in the new globalizers. However, this is entirely due to the rise in inequality in China, which alone accounts for over one-third of the population of the new globalizers. China started its modernization with an extremely equal distribution of income and extremely high poverty. Intra-rural inequality in China has actually decreased. The big growth in inequality has been between the rural areas and the rising urban agglomerations, and between those provinces with agglomerations and those without them. It has been found in general that although on average openness does not affect within-country inequality, in low-income countries it is associated with greater inequality. Regardless of its net effect, there are winners and losers from trade policies.

The combination of rapid growth with no systematic change in inequality has dramatically reduced absolute poverty in the new globalizing countries. Between 1993 and 1998, the number of people in absolute poverty declined by 14 percent to 762 million. For them, the third wave of globalization is indeed the golden wage. Poverty is predominantly rural. As the new globalizers have broken into world markets, their pace of industrialization and urbanization has increased. People have taken the opportunity to migrate from risky and impoverished rural livelihoods to less vulnerable and better-paid jobs in towns and cities. Not only has poverty declined viewed in terms of income, but other dimensions of poverty have rapidly improved. Both average years of schooling and life expectancy have improved to levels close or equal to levels reached by the rich countries in 1960. Vietnam illustrates this experience. As it has integrated into the world economy, it has had a large increase in per capita income and no significant change in inequality. The income of the poor has risen dramatically, and the level of absolute poverty has dropped sharply, from 75 percent of the population in 1988 to 37 percent in 1998. Poverty was cut in half in only 10 years. Vietnam was unusually successful in entering global markets for labor-intensive products such as footwear, and the increased employment might be expected to benefit poor household. Uganda had a similar experience: dramatic poverty reduction and no increase in inequality.

While the more globalized economies grew and converged, the less globalized developing economies declined and diverged. Their growth experience was worse than during the second wave, but their divergence has been longstanding. At least since 1960, less globalized developing economies, defined by the share of trade in income, have tended to diverge. Decline and divergence had severe consequences for poverty in its various dimensions. Between 1993 and 1998, the number of people in absolute poverty in the less globalized developing countries rose by 4 percent to 437 million. Not only were per capita incomes falling, but in many countries life expectancy and school enrollments declined.

During the second wave of globalization the rich countries diverged from the poor countries, a trend that had persisted for a century. During the third wave the new globalizers have started to catch up with the rich countries, while the weak globalizers are falling further behind.

The change in the overall distribution of world income and the number of poor people are thus the net outcomes of offsetting effects. Among rich countries there has been convergence: the less rich countries have caught up with the richest, while within some rich countries there has been rising inequality. Among the new globalizers there has also been convergence and falling poverty. Within China there has also been rising inequality, but not on average elsewhere. Between the rich countries and the new globalizers there has been convergence. The net effect is that the long trend of rising global inequality and rising numbers of people in absolute poverty has been halted and even reversed.

So, globalization in general has benefited both poor and rich globalizing countries. In some accounts, at the beginning of the 21^{st} century, we are more globalized than we were in the most globalized period of humanity's past, the first wave globalization period, from 1870 to 1914. Although, as far as world trade/income ratio is concerned, we have only just restored the level of openness of the first wave period, actually today we trade more than ever before. What happens is that around 1900 roughly two-thirds of GDP was in the goods producing sector of the typical industrial country, and now the situation is reversed, that is, roughly two-thirds of GDP is in the service sector of the typical industrial country. If trade shares are measured as ratios of international trade of goods to the output of goods production, then those shares are soon to have increased significantly from a century ago. This supports the view that international integration of markets for goods is significantly greater today than a century ago.

As far as capital flows are concerned, despite the fact that the flow compared to GDP is smaller today than during the first wave, capital flows have become more widespread in developing countries than during the first wave. Also, the advance in information and communications technologies has provided for larger investments in the form of portofolio, mainly in equity and bonds. Furthermore, we are much more globalized today in financial services than ever before.

Concerning migration, the world is today less globalized than it was before world war I, but people in different countries have never been as connected as they are now, both through telecommunication and information technologies. So in a sense the citizens of the world are better integrated than ever before.

Globalization has yielded these results simply because trade makes each trading part better off than they would be otherwise. This is so because not all countries have the same resources in terms of natural resources, labor and capital. As a consequence of it, societies in different countries can be better off by exchanging goods and services they are more competitive at producing for those they are less efficient at producing.

There has been a lot of controversy about globalization bringing about the destruction of jobs. However, the truth is that empirical evidence points that there is a net creation of jobs by globalization. The reason is that it provides for more efficiency in industries across countries. This requires for the destruction of less efficient industries and the creation and/or expansion of more efficient industries within individual countries. When a certain type of occupation is destroyed due to competition of goods or services produced in another country, new opportunities somewhere else in the economy will be created. If the country engaging in world markets is prepared to take advantage of these new opportunities, by furnishing the adequate education and training to its population, as well as by providing a good investment climate, its workers will end up with better jobs and wages than before.

Besides, consumers will be better off under trade integration, for they will have access to a greater variety of products, with better quality and lower prices. Usually, in the short run, some groups of workers will lose with globalization. However, overall there is a net gain from trade, for the country's exports will have a higher price than under autarchy, which in turn will create better paying jobs than it would otherwise be the case if the country's industries sold only to the domestic market

In fact, however, there are losers and winners. Those workers who are unskilled, especially older workers who cannot be easily retrained to take advantages of new more skilled jobs created, are the ones who generally lose. This loss is usually over dimensioned. What happens is that the jobs destroyed are more visible than the ones created, which provides for the widespread belief that globalization is dangerous. This is the reason why there has been so much stress in the harm globalization can produce. As it has been depicted, empirical data shows that it is not the case, since the number of people who live in poverty have decreased significantly (despite high world population growth). Besides, wages in the newly globalizing developing countries have grown faster than in rich countries in the last two decades. At the same time, wages in less globalized developing countries have grown more slowly than in both developed countries and in the new globlizers.

Furthermore, some very important high-tech industries can only exist in countries that are open to trade and investment. For example, **BOEING** has survived in the United States only because it imports most of its parts and outsource some of its services. The same happens to **EMBRAER** in Brazil, which imports most of its parts from competitive producers. All countries want to have high-tech companies of monopolistic or oligopolistic nature and that require economies of scale and/or aglomeration to provide for their existence. Such companies are desirable for a country because the makers of such high-tech, high-value-added final products are the ones to reap up the highest profits in the whole productive chain, due to the monopolistic or oligopolistic (uniqueness) characteristics of their final products.

Some of the important losers from globalization will be formal sector workers in protected industries. The adjustment is likely to be especially tough for older workers. Government social protection and labor market policies are very important - both for the immediate welfare of affected workers and for the longer-term welfare of all workers. To get reforms underway may require one-time compensation schemes for workers who would otherwise suffer large losses. Well-designed unemployment insurance and severance pay systems can provide protection to formal sector workers in an environment that will now have more entry and exit of firms. The poorest people cannot be reached by such systems, but there is huge potential to reduce their vulnerability to shocks through self-targeting programs such as food-for-work schemes. Social protection can be a dynamic force for growth and innovation beyond the gaining of acceptance for change. It can be crucial to the ability of poor people to take the risks involved in entrepreneurship. Finally, the combination of openness and a well-educated labor force produces especially good results for poverty reduction and human welfare. Hence, a good education system that provides opportunities for all is critical for success in this globalizing world.

2. Features present in successful countries

Given the recent changes that have taken place during the third wave of globalization, where some poor newly globalizing countries, accounting for more than 3 billion people, have been able to successfully integrate themselves into the world economy, it is important to discuss the conditions a country should pursue in order to face the challenges of globalization and get the most out of it. One of the facts that have changed the international markets lately is the appearance of capital account crises in the 1990s. This has brought into play a new threat for newly globalized developing countries that have not been doing their homework. Since the IMF was conceived to face only current account crises, highly indebted countries that did not adopt responsible fiscal policies, did not provide for the existence of a domestic sound financial system, have been hard hit by capital account crises. These weaknesses have been made worse in countries that adopted a pegged currency, such as Argentina, Brazil and Mexico. Brazil had put in place a responsible fiscal policy, but given its high fiscal and external debts, its low exports/GDP ratio and an overvalued currency, it, too, suffered from a capital account crisis in 1998-1999.

As far as economic indicators are concerned, the developing globalized country of today should watch its accounts and present these indices so as to lower their risk perception and attract investment: accumulated total external debt (both private and public) less than 50% of GDP; accumulated total external debt less than 275% of annual exports; external debt principal payments less than 30% of export revenue; debt interest payments less than 20% of annual revenue. However important these indicators are, when a country is evaluated by investors, other aspects are taken into consideration, such as the degree of diversification of its exports, the composition of exports in terms of highly-value-added manufactured products, educational level of its workforce, country's history, culture, political stability, language, social integration level, etc.

While political stability and the quality of economic and financial policies are two important keys to success, there has to be a fundamental respect for the rule of law and the enforcement of commercial contracts and business rights. Without this foundation, individuals and institutions will not thrive in the country. No country has truly succeeded without the existence of rule of law (i.e., has had sustained development and growth for long periods of time).

Furthermore, in assessing a country, its current account should be analyzed in terms of its size as percentage of GNP; if negative or positive; its trends; its sustainability; what it is financing (consumption or investment), the feasibility of the projects being financed; how it is being financed (debt or FDI); if it is debt (is it "hot" money) The country's export structure is also important. It is crucial to know the income and price elasticities of the goods mostly exported. It is positive the higher the income and price elasticities of demand are in the international market (luxury goods, for example), and the lower the price elasticity of supply is in the international market (for example, oil). Also, the more diversified the exports, the better. It is important that the county have a high percentage of exports as compared to GNP (Mexico, for example, exports over 40% of its GNP). The trend in the long run should be one that improves the country's terms of trade (price of exports / price of imports).

On the other hand, the import structure should be one in which the goods being imported had better be essential and mostly used for investment. Having a high import/GDP ratio is also important, for it allows for the country great margin of adjustment if it is to face a capital account crisis (if the country erects temporary barriers to imports, a little percentage fall in imports means a lot in terms of its GDP).

The exchange rate is also an important variable. Highly indebted countries that have adopted pegged currencies, such as Argentina, Mexico and Brazil, have suffered severe capital account crises. So, a country with pegged currency, high external debt, relatively high inflation, low productivity growth, inflexible labor laws, is very likely to undergo capital account crises when its currency gets overvalued. If that happens, there will be capital flight from the country, which will undervalue its currency, wipe out its reserves, increase its debt in terms of its domestic currency substantially. Since the IMF was not created to face capital account crises, but only current account crises, it is very likely that such a country will default on its external debt, which is exactly what happened to Argentina. So, a highly indebted country had better adopt floating exchange rates and inflation targeting policies to seek price stability.

Other aspects such as the openness of the economy to trade and investment, the soundness of its financial system, the structure of tariffs, FDI and history and regulation are also relevant. It is important to have a more open economy, which provides for imports and increased efficiency of companies. It is also desirable that tariffs are even and non-distortionary. It is fundamental that FDI be given non-discriminatory treatment.

Some indicators of the domestic economy are important. The GDP and the GDP per capita (both nominal and in PPP, real, terms), the growth rate, and inflation are key elements to be analyzed. Other aspects related to the budget are also relevant: composition of government expenditures, how taxes are distributed and how effective tax is collected, deficit or surplus, factors causing deficit (subsidies, state enterprises, consumption versus investment, military expenditures), tax as percentage of GDP, trend and demographic structure. The higher GDP, GDP per capita, and growth the most promising is the country's market. On the other hand, inflation, deficit/GDP ratio, interest rates should be the lowest possible. It is also important that the country shows high and growing labor productivity, and not a very high unit labor cost, so as to hold the country's competitiveness high.

As for the financial markets and their supervision, they should be ideally liberalized, and there should be competition in it. It is desirable a good quality of regulation and supervision. The central bank should be free from political influence, and therefore be independent and responsible. Foreign banks should be welcome and be given equal opportunities to operate.

As for the labor markets, it should be the least regulated possible from the stand point of the investor. Socially speaking, some regulations are necessary, but they should not be excessive so as to make the labor market too inflexible (Argentina is one such case).

The markets should be the most liberal from the investor point of view. It is of greatest importance to have a stable regulatory framework, making sure rules do not change during the "game." In order to face the challenges of globalization, however, it is important that countries build a comprehensive social protection net, specially to undermine unemployment dire consequences in the short run due to the closure of less efficient companies. What is more, the most unskilled workers are the ones who are mostly affected by openness in the short run, and thus should be more closely taken care of. Wide access to education and extensive training and job placement programs are some of the solutions for this great challenge.

In what concerns to the broad legal framework, commercial laws should allow for a good investment climate and should be enforced. The country's institutions should be strong and trustworthy, allowing for accountability, swift justice, so as to avoid widespread corruption.

Most important of all is the investment climate, which to a certain point is determined by the combination of all the features far discussed. However, the country's infrastructure is an important determinant of the investment climate, namely the educational level of its workforce and population in general, its logistics in terms of transportation (roads, ports, waterways, railways, etc), its telecommunications and technological systems, etc. Despite the great importance of all this, one feature that is decisive to determine the investment climate, the risk of doing business in a country, is its legal system, the warranty of the existence of rule of law that truly protects property rights. In order to better illustrate the importance of a judiciary system that works, I quote Hernando de Soto, in "The Mistery of Capital, Why Capitalism Triumphs in the West and Fails Everywhere Else:"

"The Move from a Pre-capitalist to a Capitalist Property System

Without an integrated formal property system, a modern market economy is inconceivable. Had the advanced nations of the West not integrated all representations into one standardized property system and made it accessible to all, they could not have specialized and divided labor to create the expanded market network and capital that have produced their present wealth. The inefficiencies of non-Western markets have a lot to do with the fragmentation of their property arrangements and the unavailability of standard representations. This lack of integration restricts interaction not only between the legal and the extralegal sector but among the poor themselves. Extralegal communities do interchange with each other, but only with great difficulty. They are like flotillas of ships that remain in formation by navigating with reference to each other rather than to some common and objective standard, such as the stars or the magnetic compass.

Common standards in one body of law are necessary to create a modern market economy. As C Reinold Noyes has pointed out:

Human nature demands regularity and certainty and this demand requires that these primitive judgments be consistent and thus be permitted to crystallize into certain rules – into "this body of dogma or systematized prediction which we call law." … The practical convenience of the public… leads to the recurrent efforts to systematize the body of laws The demand for codification is a demand of the people to be released from the mystery and uncertainty of unwritten or even of case law.

To make the transition from a condition where people already rely on a diversity of extralegal practice established by mutual consent to one codified legal system is a daunting challenge. As we have seen, this is what the nations of the West had to do to move from pre-capitalist "primitive judgments" to a systematized body of law. That is how they lifted their bell jars. However, as successful as those nations have been, they were not always conscious of what they were doing and left behind no clear blueprint. Even in Britain, eager to extend the benefits of the Industrial Revolution, reform efforts went on for almost a full century (from 1829 to 1925) before the government was in a position to make sure that real estate assets could be centrally recorded and easily transferred, John C. Payne sums up how difficult and erratic property reform was for England:

A great many statues were passed, and English property law was made over from top to bottom. Much of this reform was ad hoc improvisation, and one gets the impression that the leaders of the movement did not always have a clear idea of what they were doing or why they were doing it. English land law had become so technical and had gained so many accretions through the centuries that the task must initially have seemed almost overwhelming. The difficulty was that there was so much detail to be attended to it that it *was hard to get to the heart of the matter. So the English reformers began to strike about them with all good will but with more energy than clarity of concept. In the long run, they did their work well, but it took them a century to do it, and in the interim they attempted many unsuccessful experiments and were ultimately forced into a number of compromises."*

If all of these main features of a country are accurately assessed, then the spread of a country's borrowing over the U.S. T-bill rate would be a good measure of the short term country's risk. But that is rarely the case. Often agencies and analysts make distorted judgements of countries.

The features above described should be pursed by a country, especially if it is a developing one, if it is to succeed when opening itself up in the present era of globalization. However, since both North-South and South-South barriers to trade remain high relative to North-North's, a new round of world trade negotiations has got to take place. Rich countries are a lot open on average, but to other rich nations. Developed countries maintain protection in exactly the areas where developing countries have comparative advantage (especially agricultural products, foodstuffs, textiles, garments, etc), and there would be large gains to poor countries if these were reduced. Furthermore, developing countries would gain a lot from better access to each other's markets- barriers between them are still higher than those from developed countries. These improvements in access are best negotiated in a multilateral context.

Another development that would be of greatest importance for the poor nations of the world, mainly the ones in sub-Saharan Africa, is debt relief. It would not cost much in terms of creditors' countries GDP if they were to forgive the debts of several debt burdened small developing countries around the world. On the other hand, debt relief is a pre-condition for many of these countries to improve their investment climate so as integrate successfully in the global markets. Their integration into the international economy would be quintessential to augment world demand for goods and services, and further stimulate the global economy. That is what is happening to China today, as it is driving up the price of commodities such as cement, steel, nickel, cereal, meat, etc (40% of the cement in the world is being consumed by China, in 2004) . This is a result of its successful insertion in the global economy in the last decades as a great exporter of manufactures. The same could happen if other marginalized countries managed to successfully integrate themselves into the world economy.

3. A Successful Story: The Case of China

As mentioned previously, some countries have managed to gain tremendously in the third wave of globalization. China stands out among these countries. Latin American countries, except for Chile, Mexico and few others, have not done very well. The difference seems to lie fundamentally on the position these countries departed from when they opened up themselves to trade and investment. While Asian countries had little external debt and low inflation rates when they opened up their economies, Latin American countries had both excessively high external debts and inflation.

So, when these nations opened up their economies in the 1990's, foreign investments were reluctant to go to Latin American countries because of the likelihood of default on the debt, creditors' loss of resources and consequent economic stagnation. To make matters worse, many Latin American countries pegged their currency to the dollar, in an effort to fight inflation. Since the currencies ended up getting overvalued, current account debts mounted, and world markets' suspicion of imminent devaluation -which would lead to growing public debt, credit restriction and economic slowdown- became a self-fulfilling prophecy. As a consequence, the rapid growth experienced by Argentina and Brazil, for example, at the beginning of their overture was offset by several years of stagnation, due to the capital account crises they went through.

Meantime, the whole world's gaze is fixed on China—not just because the country is vast and growing rapidly, but because it profoundly affects the fortunes of companies everywhere. Around the globe, shelves are stacked with the low-cost goods churned out by “the world's workshop.” Chinese-based manufacturers suck in imports and dictate global prices of everything from steel to microchips. For foreign companies, a huge market beckons as China liberalizes its relations with the rest of the world, having acceded to the World Trade Organization in 2001.

In 1978, after years of state control of all productive assets, the government of China embarked on a major program of economic reform. In an effort to awaken a dormant economic giant, it encouraged the formation of rural enterprises and private businesses, liberalized foreign trade and investment, relaxed state control over some prices, and invested in industrial production and the education of its workforce. So that, World Bank’s investment climate studies reveal that China has relatively good environment for starting firms and getting basic infrastructure services. By nearly all accounts, the strategy has worked spectacularly.

While in pre-1978 China had seen annual growth of 6 percent a year (with some painful ups and downs along the way), post-1978 China saw average real growth of more than 9 percent a year with fewer and less painful ups and downs. Per capita income has nearly quadrupled in the last 15 years, and a few analysts are even predicting that the Chinese economy will be larger than that of the United States in about 20 years. Such growth compares very favorably to that of the “Asian tigers”- Hong Kong, Korea, Singapore, and Taiwan Province of China –which, as a group, had an average growth rate of 7-8 percent over the last 15 years.

Curious about why China has done so well, an IMF research team recently examined the sources of that nation’s growth and arrived at a surprising conclusion. Although capital accumulation – the growth in the country’s stock of capital assets, such as new factories, manufacturing machinery, and communications systems – was important, as were the number of Chinese workers, a sharp, sustained increase in productivity (that is, increased worker efficiency) was the driving force behind the economic boom. During 1979-94 productivity gains accounted for more than 42 percent of China's growth and by the early 1990s had overtaken capital as the most significant source of that growth. This marks a departure from the traditional view of development in which capital investment takes the lead. This jump in productivity originated in the economic reforms begun in 1978.

Economists studying China face thorny theoretical and empirical issues, mostly deriving from the country's years from central planning and strict government control of many industries, which tend to distort prices and misallocate resources. In addition, since the Chinese national accounting system differs from the system used in most Western nations, it is difficult to derive internationally comparable data on the Chinese economy. Figures for Chinese economic growth consequently vary depending on how an analyst decides to account for them.

Although economists have many ways of explaining- or modeling- economic growth, a common approach is the neoclassical framework, which describes how productive factors such as capital and labor combine to generate output and which offers analytical simplicity and a well-developed methodology. Although commonly applied to market economies, the neoclassical model has also been used to analyze command economies. It is an appropriate first step in looking at the Chinese economy and yields useful "benchmark" estimates for future research. The framework does, however, have some limitations in the Chinese context

Original data for the new IMF research came from material released from the State Statistical Bureau of China and other government agencies. Problematically, the component statistics used to compile the Chinese gross national product (GNP) have been kept only since 1978; before that, Chinese central planners worked under the concept of gross social output (GSO), which excluded many segments of the economy counted under GNP. Fortunately, China also compiled an intermediate output series called national income, which lies somewhere between GNP and GSO and is available from

1952 to 1993. After making appropriate adjustments to the national income statistics, including adjusting for indirect business taxes, these data can be used to analyze the sources of Chinese economic growth.

The economic rise of this highly populated country (population around 1.3 billion, 2004) has been having a great impact in world markets. Growth of Chinese demand for commodities rises at rates significantly above world total. China's demand for major commodities could rise from current 20% to around 25% of world's total in five years. In 2006, it is estimated that 5% of the Chinese population (about 70 million people) will be able to afford to have cars (up from 1% in 2001), 8% (110 million), life insurance (up from 4% in 2001) and 9% (125 million), real state (up from 5% in 2001). Today, China is responsible for 20% of the world consumption of aluminium, copper, alumina and zinc, 30% of the iron ore and crude oil, 10% of the nickel, 25% of stainless steel, and 40% of the cement (Source: CEIC).

However, since its growth lately have been investment driven, and these investments have been financed mainly by state banks, which do not evaluate properly the feasibility of the projects they finance, fears are that the country might face difficulty. Investment represented 47% of GDP in 2003, and was responsible for three quarters of growth. Total factor productivity growth is no longer playing a large role in economic expansion. It has grown just 2% a year on average from 1995 to 1999. Also, capital/output ratio, which used to be in the 2-3 range, is now over 4. Easy credit is producing massive overcapacity, leading to deflation, more bad debts and fewer new jobs. Already, nine-tenths of manufactured goods are in oversupply.

China's developing capitalism is not solidly based on law, respect for property rights and free markets. It is unbalanced and potentially unstable. Multinational companies operating in China have often failed to produce an adequate return on their investment, or indeed a profit of any sort. That is partly their own fault, because they overestimated the market and underestimated the competition. With experience, more are getting it right. However, the business climate in China remains capricious and often corrupt.

Chinese firms contribute to that climate. State-owned enterprises are much more concerned to maintain patronage and employment than to generate profits, and even the best are not globally competitive. China's fledgling private businesses, by contrast, have shown astounding growth and produced the country's first crop of wealthy entrepreneurs. But they are still too small to offer an effective counterweight to the state sector.

In 1979, China's public debt was zero. Nowadays, it should be close to US$ 1 trillion. Since statistics are difficult to be obtained, it can even be somewhat higher. Even at this level, it is about 70 percent of GDP (at US$ 1.4 trillion, the world's sixth largest), which is a somewhat high debt ratio for a developing country. The budget debt is now over 3% of GDP, and has also bypassed IMF's threshold of prudence. Yet, China has international reserves of around US$ 400 billion, which allows for it to roll the debt at low interest rates, differently from Brazil and Turkey.

Perhaps the real test for Beijing will be when it bites the bullet and really tries to restore the four big state-owned banks to health, a step that most international agencies consider is urgently needed. Estimates of the cost to bail out the banks range from $200 billion to $600 billion. This will also eventually be borne by the taxpayer. Together with un-funded pension liabilities, estimated at 50%-100% of GDP, these obligations will put enormous pressure on Beijing to curb its spending. Even so, it might not be enough to avoid a financial crisis that would wipe out much of the progress from two decades of economic reform. Some experts believe disaster is still avoidable, but the longer the spending spree lasts while true banking reform is delayed, the greater the risk of collapse.

Despite all these problems, government driven investment has been geared towards important infrastructure works, which should help improve the country's investment climate and capital/output ratio in the long run. To get a sense of what is going on, one of the world's biggest public-works projects is happening in China: Channeling water from China's Yangtze River to the parched Yellow River in the north. The planned expenditure: $59 billion. Somewhere else, track-laying teams are driving through mountains and across China in a race to add 7,000 kilometres of new railway line by 2007. The budget: $ 42billion. Work has already begun to modernize Beijing for the 2008 Olympic Games. Estimated spending: $34 billion. Shanghai officials say they will keep up the pace of expanding public facilities in 2003. The cost: $6 billion.

However incomprehensible and unpredictable China is, the combination of growth, stability and potential has set off a tidal wave of foreign enthusiasm for China. Businessmen return from pilgrimages to Shanghai and Beijing convinced that this is China's century. Robert Bestani, head of the private-sector arm of the Asian Development Bank, calls the phenomenon “future shock”—change so rapid that it seems like a vision of the future. Dietmar Nissen, East Asia president of BASF, a huge chemical company, says that “the speed and scale of growth in China over the past 12 years is a miracle. It is a miracle that China is developing in such an orderly fashion.” Messianic terms are *de rigueur* when discussing the country's 1.3 billion consumers, its vast pool of low-cost workers and its need for every imaginable product and service. Goldman Sachs, an investment bank, predicts that by 2040 China will overtake America as the world's biggest economy.

3.1 China’s Trade

It is important that the Chinese trade be analyzed, for it has been one of its growth main driving forces. Customs statistics show that in 2003 China's total import/export worth reached 851.21 billion US dollars, rising 230.4 billion dollars, or 37.1 percent up over the previous year, being the year of fastest growth since 1980. The import/export scales both exceeded 400 billion dollars and brought a whole-year trade surplus of 25.53 billion dollars.

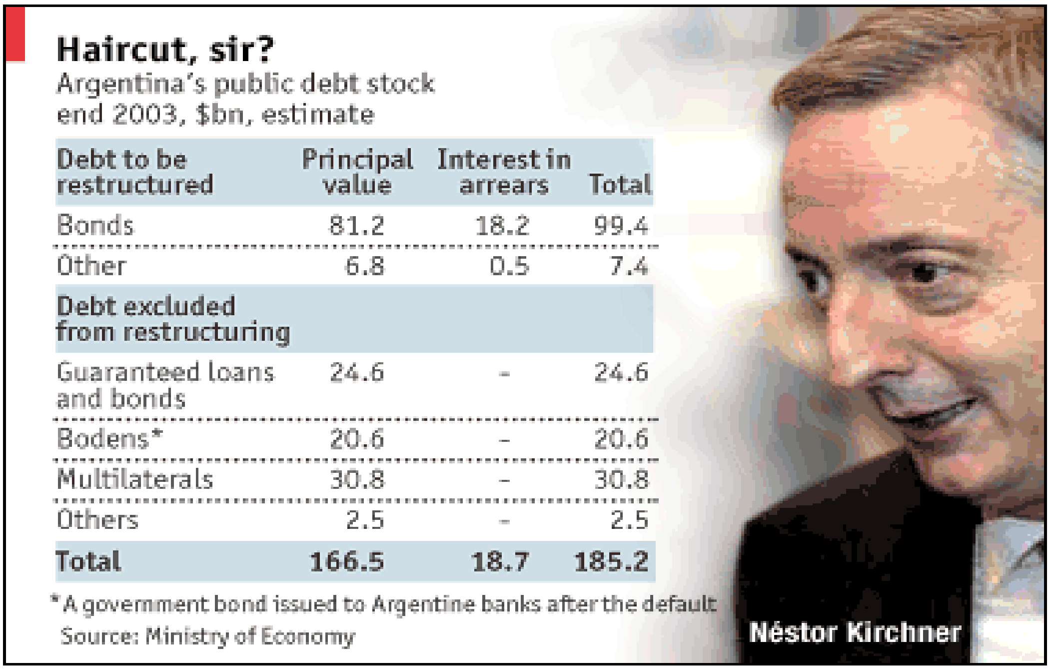
Statistics show that in 2003 China exported a worth of 438.37 billion dollars, up 34.6 percent, and imported a worth of 412.84 billion dollars, up 39.9 percent. The total import/export value of December reached 90.4 billion dollars, hitting a monthly historical record and bringing a trade surplus of 5.72 billion dollars.

Although the domestic tertiary industry suffered much loss during the first half due to the SARS epidemic, the whole-year export maintained a momentum of high-speed growth. The accumulative export growth stayed above 30 percent throughout the year and since September monthly export surpassed 40 billion dollars until the yearend, which turned out as high as 48.06 billion dollars in December.

Statistics also showed that China enjoyed in 2003 overall fast-speed growth in bilateral trade with its major trade partners. The bilateral trade volume with Japan, the United States and EU all exceeded 100 billion dollars, being the first time with the US and EU. Japan has been China's biggest trade partner for 11 successive years, and the total volume of China-Japan trade grew by 31.1 percent. Bilateral trade with the US increased by 30 percent and with EU 44.4 percent. Meanwhile, China also achieved a growth rate over 20 percent with other major trade partners, and those with ASEAN and ROK both exceeded 40 percent.

Among 2003 exported commodities half was taken by mechanical and electrical products, and traditional staple product enjoyed good export trend; among imported commodities, much growth was brought by primary products and steel, car were also hot for import.

4. **Unsuccessful Story: The Case of Argentina**



Haircut, sir?

Argentina's public debt stock end 2003, $bn, estimate

Debt to be restructured	Principal value	Interest in arrears	Total
Bonds	81.2	18.2	99.4
Other	6.8	0.5	7.4
Debt excluded from restructuring			
Guaranteed loans and bonds	24.6	-	24.6
Bodens*	20.6	-	20.6
Multilaterals	30.8	-	30.8
Others	2.5	-	2.5
Total	**166.5**	**18.7**	**185.2**

*A government bond issued to Argentine banks after the default

Source: Ministry of Economy

Among the world's richest countries in the past, Argentina's per capita has ranked above that of Germany in the 19th century, and of Canada in the 1930s. After many years of economic bad performance, Argentina is today a middle income country, with ppp per capita income around US$ 11,000. In the 1980s, Argentina underwent a severe period of hyperinflation comparable only to the German experience in the 1920s. Inflation topped 3,000% in 1989 after hovering in triple digits throughout the decade, and the value of the peso nearly disappeared. A long-standing policy of economic nationalism had shut off Argentina from world trade and capital flows for decades. Confident in their ability to go it alone - supported by a rich pool of natural resources - successive governments built barriers around the economy to protect local industry. The economy faltered. But after decades of chronic high inflation and flat growth, Argentina began a remarkable economic restructuring program under the Presidency of Menem. At the core of the government's plan was the Convertibility Law, passed in 1991, which set the peso's value at US$1. The country's finances quickly stabilized. The plan also freed the Argentine economy: most state companies were privatized, trade and investment were freed and tax collection improved a bit. As a result, growth surged in the early 1990s and inflation plummeted.

The Convertibility Plan of 1991 was central to policy until 2001. The law required the government to peg the peso at par with the US dollar and back the money supply with foreign exchange reserves. However, the peg has its weaknesses. The system's vulnerability to external shocks is the subject of criticism. With the peso fixed to the US dollar, Argentina was unable to use interest rate adjustments as a tool for managing the economy. As a result, commercial interest rates tended to track movements in US rates even if the economic cycle in Argentina was not in synch with developments in the United States. The table in the next page shows some economic indicators of the country.

So, in 1991, Argentina implemented an ambitious structural reform program that brought about profound changes in the economy. The monetary and exchange rate regimes and the banking sector were no exception. In fact, during that decade the country displayed a unique combination of characteristics:

Jun 23rd 2003

From the Economist Intelligence Unit

Source: Country data

	1999	**2000**	**2001**	**2002**
GDP per head ($ at PPP)	12,330	12,402	12,000	10,640
GDP (% real change pa)	-3.39	-0.79	-4.41	-11.3
Government consumption (% of GDP)	13.72	13.78	14.16	12.22
Budget balance (% of GDP)	-1.68	-2.39	-3.25	-1.45
Consumer prices (% change pa; av)	-1.17	-0.94	-1.07	25.87
Public debt (% of GDP)	42.99	45.04	53.76	111.5
Labour costs per hour (USD)	4.16	4.23	4.06	1.35
Recorded unemployment (%)	13.03	14.55	16.4	18.8
Current-account balance/GDP	-4.2	-3.12	-1.69	8.6
Foreign-exchange reserves (m$)	26,252	25,147	14,553	10,489

- The exchange rate/monetary regime was a currency board between 1991 and 2001;
- There were no obstacles to capital flows and tighter prudential regulations were introduced; and

- Private portfolios and banks' balance sheets were highly dollarized.

The effects of the reforms on the financial side of the economy were encouraging in the first half of the 1990s. In the 1991-95 period, the economy grew quickly and there was a marked increase in the level of financial deepening. But in spite of this, the macroeconomic environment remained volatile and there were important credit-crunch episodes when the so-called Tequila effect and the Russian-Brazilian crises hit the economy in 1995 and 1998, respectively. In the second half of 1998 the economy entered a lengthy period of persistent recession, which ultimately resulted in a financial crisis at the end of 2001. In January 2002, the Currency Board was formally abandoned and the process of financial reform was greatly reversed. Capital controls were reintroduced and prudential regulations were softened.

Evidence suggests that in spite of market-friendly financial reforms and the higher level of financial development, the financial constraints facing Argentine firms remained tight throughout the 1990s and that market segmentation was important—i.e., different kinds of firms enjoyed different access to capital. The causes and consequences of financial constraints that firms face are much better understood today than in the past (for a survey, see Hubbard, 1998, and Schiantarelli, 1996). In the case of Argentina, the few existing studies point to the relevance of financial constraints.

So, in analyzing Argentina, its performance in the 1990s were better than that of most Latin American countries up to 1998, but worse than most afterwards. Argentina's real GDP growth in the period 1991-97 averaged 6.7%, and the country seemed to have entered a virtuous circle of growth. However, after slowing its growth rate in 1998, to 3.9%, it experienced a long recession from 1999 through 2002, with a GDP drop in the period of approximately 20%. The economy recovered in 2003, with growth of 8.7 %, but specialists argue that it is not sustainable, for it is a result of use of underutilized capacity, not of new investments. Since the country does not have access to world credit markets, it is argued it cannot grow sustainably at high rates. Even more so that because it is undergoing an energy crisis.

The point from which Argentina departed when it opened up its economy may have made all the difference when one compares its failure with the success of Asian globalizers, such as China and India. In 1991, Argentina's consolidated public sector debt was about 30% of GDP, and it had a rampant inflation. China, when it started opening up its economy, had virtually no public debt and inflation.

The fact that Argentina's public debt was relatively high, its inflation had been historically high, its institutions not very well consolidated, played a large role in the developments that took place in Argentina in the following years after the stabilization plan adopted in 1991 (the Cavallo's Plan, after the then Minister of Finance). In order to bring down inflation, Argentina pegged the peso to the dollar, on a one to one basis. It opened up its economy to imports so as to provide for prices to stop from rising. Inflation came to a halt. As the peso became overvalued in comparison to the dollar, current account debts mounted, firms and the government started borrowing in dollars to meet their financial needs, the seeming stabilization attracted a lot of short-term capital. All of this made the economy too vulnerable. International markets started to realize that the Argentinian real debt was much higher than it appeared to be, given that the devaluation of the peso was unavoidable (the central bank had few reserves to back up the value of the peso), and an undervalued peso would make the debt go sky high, as it actually ended up happening.

But why did the peso have to be devalued? While the economy was booming, the government did not pursue responsible fiscal policy. It should have run fiscal balance surplus, but it did not. So, despite the fact that the country's consolidated public debt was not too high in 1991 (about 30% of GDP), as the peso became overvalued, interest rates suffered an upward trend so the country could attract foreign capital to compensate for its growing current account debt. As a consequence of relatively high interest on the debt, low or negative government primary balance surplus, the public debt had reached 48% of GDP in 1998. With the major capital account crises that started in Asia, moving to Russia, Brazil, then to Turkey, the Argentine economy entered a long deep recession after 1999. This was mostly due to the depreciation of the Brazilian Real. Since Brazil represented the main destine of Argentina's exports (25%), Argentina's foreign capital needs increased even more. To make matters worse, the little diversified composition of its exports (based mainly on commodities) caused Argentina to undergo great loss on its terms of trade, due to the fall in prices of commodities in the world market in the 1990s. All that combined with the rising of interest spreads in emerging markets after the outbreak of the different crises around the globe, made Argentina's debt burden ever larger.

This situation led to capital outflow, and devaluation of the currency after 2001, which took the financial system, the private enterprises and the government into bankruptcy, for the two latter were highly indebted in dollars, and the first was their main creditor. The IMF did not provide Argentina with the rescue package it asked for, due mainly to political inflexibility of the Argentinian government. As a result, the country failed to meet with its international creditors, and is presently (2004) relying only in domestic financing to support its growth. However, without access to the international financial markets, growth should not be sustainable in the long run.

Some lessons can be learnt from Argentina's experience. The country's vulnerability became high due to mutually reinforcing effects: I- the dollar peg and its consequent overvaluation, which hid from the public view the mounting fiscal solvency problems, delaying their correction; II- a fragile fiscal situation inherited from the expansion in the boom years forced a contraction in the recession, further damaging growth expectations and solvency perceptions, and III- a highly dollarized financial system, which meant that the required real exchange depreciation threatened the debt repayment capacity of households and firms in the non-tradable sectors – weakening banks and raising large fiscal contingencies, and high exposure to government risk worsened the banking problem.

What should have been done by Argentina? While the market friendly liberalization measures taken by Argentina should not be condemned, the country failed to adopt some correct actions at the right time. Until 1998, when the country was experiencing high economic growth, Argentina had the option of keeping the peg, but reducing vulnerability by: I- strengthening the fiscal position (surplus); II- flexibilizing labor and other markets to absorb shocks; III- strengthening prudential regulation through: a- higher capital requirements for loans to households and firms in non-tradable sectors; b- liquidity earmarked for demand deposits (payments system); and c- limits on exposure to government risk.

On the other hand, Argentina could have chosen to successfully exit the peg before 1999 by: I- strengthening the fiscal position to build credibility; II- flexibilizing markets to remove inflationary bias; and III- encouraging gradual de-dollarization. After 1999, these options would no longer be effective, and whatever path the country chose, it would not be able to avoid the crisis.

After 1999, if the country chose to keep the peg, it would undergo a protracted recession and deflation. It would mean a demanding test on Argentina's fragile institutions, and eventual debtor (and bank) solvency problem from real exchange rate correction. If dollarization were chosen, perhaps it would have been the least-costly option in the short run, with a somewhat easier adjustment, no currency risk and (perhaps) lower interest rates. Still, eventual debtor (and bank) solvency problems from real exchange rate correction would have to be faced. In both cases, success would be uncertain, and continued exposure to the same problems in the future. If, on the contrary, Argentina just devalued the Peso, it would undergo immediate banking and fiscal crisis due to balance sheet mismatches. If it "pesified" private domestic debts and devalued the peso, it would destroy confidence in the financial sector and require a deposit freeze. This option was the one the country tried to implement, but it could not prevent the economy from contracting some 20%, before starting to recover GDP growth in 2003.

So, some lessons can be learned from the Argentine experience. First, hard pegs are high-risk when against a currency of a country that is not a big trade partner (Argentina's trade with the U.S. represented 2% of GDP). Such pegs cannot survive large real shocks bound to happen. Exit can have huge cost in bad times. Second, pro-cyclical fiscal policy can be disastrous. Fiscal stability requires a strong institutional framework, encouraging surpluses (discouraging deficits) in booms. Third, banks' prudential regulation in dollarized economies needs to be tougher than previously thought. Finally, a hard peg is no shortcut to credibility, nor a substitute for poor institutions. It does not automatically result in price flexibility and fiscal discipline. Its institutional requirements (fiscal, financial, labor) are as stringent as those of credible floats.

5. The Brazilian Experience and Lessons Brazil Should Learn.

In the 20th century, Brazil made tremendous progress, being together with Japan and Taiwan, one of the three best performing economies throughout the century. This great leap forward can be best understood if we consider that Argentina's per capita income around the year 1900 was 30 times that of Brazil, and today, they are about the same in the two countries. However, after 1980, the country's performance has not been impressive in terms of economic growth. Only around the year 1998 was it that per capita income in Brazil matched that of 1980. It is true, however, that after inflation has been brought to single digit levels, the standard of living of Brazilians has improved somewhat, albeit per capita income remains roughly the same as that of two decades ago. When Brazil experienced high inflation, it was estimated (by Brazilian famous economist Mario Henrique Simosen) that 25% of GDP was wasted with inflation related goods and services. So, actually, meaningful GDP per capita represented just 75% of what it is today. If this estimate is correct, meaningful per capita income has gone up by a third in the last decade (The Real Plan, which has brought inflation to a halt, is turning 10 years old, in July, 2004).

Furthermore, ever since the UN started measuring the Human Development Index (HDI) 26 years ago, Brazil is the country that has made most progress. The index is composed by three elements: income, longevity and education. So, while the country has not advanced much in income, it has in the two other indicators. Also, according to the UN, Brazil has stood out in the last decades as one of the most successful countries in bringing down the number of people living in poverty. This has happened despite there has not being any improvement in inequality, for the income of the poorest grew less than that of the richer, but enough to take a substantial number of people from bellow the line of poverty. So despite not showing much improvement in per capita income, Brazil has shown meaningful progress in the last decades.

Why is it that Brazil did not perform well economically exactly at a time when the new globalizers have done so well? The answer is not easy and not straightforward, but there are some determinant factors that seem to have played a large role in the performance Brazil has had in the last two decades. The development model adopted by the military government, based upon both cheap oil and capital, went into crisis at the end of the 1970s. As a consequence of it, Brazil started the 1980s with a high external debt and suffering from an adverse supply shock due to oil prices' hike. Therefore, it had to generate a trade surplus to meet its services on the external debt. As a consequence of it, the inflation rate reached three digits as early as 1984, due to the nee of maintaining a weak currency and high barriers to imports. Trapped with both a high external debt and staggering inflation, the country kept somewhat closed until 1990. Only then is it that it liberalized its trade, by lifting import tariffs and quotas from several goods, and implemented some reforms, such as the administrative one. It also devised a plan to fight inflation in 1990, adopting bank account freezes for deposits above US$ 1,000.00, which did not prove to be successful. After facing two years of recession as a result of these measures, the country started a fast growing cycle in 1993 that lasted until 1997. In July 1994, the Real Plan was launched in another effort to bring inflation to a halt. The Brazilian currency was fixed to the dollar, being allowed to vary just to a certain extent, with heavy intervention of the central bank to keep the relative value of the Real to the dollar in the established range. This time around, inflation was successfully brought to single digit levels, and has kept under control ever since.

In the second half of the 1990s, Brazil implemented an austere fiscal policy and privatized several inefficient state companies, specially in the telecommunications and energy sectors, among other liberalizing measures. However, the Real got overvalued as a result of heavy attraction of FDI investment (reaching US$ 30 billion in peak years) and deliberate policy to allow for its appreciation in an attempt to keep inflation low, by means of competition with imports. So, with the outbreak of the Asian crisis in 1997, followed by the Russian, Brazil was forced to devalue its currency in January 1999. Differently from South Korea, Russia and others, Brazil managed to recover very fast from the crisis and did not go into recession. This was due to the fact that Brazilian companies were not highly indebted in dollars, which was not the case of South Korean enterprises. In 2000, Brazil started growing fast again, but was slowed down by the energy crisis of 2001. With President Lula's rise to power in 2003, and the adjustments adopted by the government in its first year, the country had its first recession after 11 years of economic expansion, but Brazil suffered only a small contraction of –0,2%.

Lately some important developments have taken place in the reform front. The volatility of the economy helped to persuade Congress of the need for some difficult fiscal reform measures, including the Fiscal Responsibility Law. This powerful law, introduced in 1999, restrains public spending levels and limits payroll expenses to 60% of the annual budget, at the state and municipal levels as well as at the federal level. It forbids new spending authorisations without revenue resources, limits pre-election spending and forbids the federal government from rolling over state and city debts. Although national debt levels have remained high and of concern, this law has helped to stabilise the debt to GDP ratio. Furthermore, long claimed important fiscal and social security reforms were passed through congress in 2003. Also, an important change in the bankruptcy law has taken place. This will have the effect of decreasing the risk component associated to loans, because it facillitates the seizing of collaterals by creditors in case of defaults.

Now the economy is expected to enter a new virtuous circle, as both external and public debt are declining, and so are interest rates. Recent data (as of April, 2004) show signs of strong GDP growth, substantial increase in exports (30%), and upward trend in inflows of capital. Estimates indicate a trade surplus of US$ 27 billion and GDP growth of 3.5% in 2004. That is superior to the Chinese trade surplus in 2003, which was US$ 25.2 billion, and much higher than the Chinise trade surplus estimate for 2004, which should be around US$ 10 billion.

As above demonstrated, Brazil was not able to reap up substantial benefits from the third wave of globalization, mainly because it found itself deeply indebted and with high inflation at the beginning of the 1980s. As a consequence, it could not attract foreign capital in the levels it needed in order to grow fast, due to investors' lack of confidence in the country's capability of paying off its high debt. When it finally opened up its economy, it had to fight inflation, which required the adoption of a strong currency and consequently high interest rates. As a result, the country lost international reserves (which where around comfortable US$ 80 billion in 1994), due to the several capital account crises of the 1990's, experienced high current account deficits through the 1990s, and did not manage to grow over 5% a year on average. In short, its high debt and staggering inflation at the end of the 1980s prevented the country from taking full advantage of the third wave of globalization so far.

In trying to point out policies Brazil should follow in order to become a successful globalizer, one should stress that the country had better pay close attention to some important economic indicators, as it has done, to a certain extent, but not to the level it should. Rating agencies and foreign inverstors alike place great stress on these indicators (ratios): total external debt/GDP, total external debt/exports, external debt principal payments/exports, debt interest payments/exports, and gross total public debt/GDP. Brazil's accumulated external debt (public and private) ended the year 2003 at US$ 214.9 billion, which meant 40.6% of last year Brazilian GDP (US$ 529 billion). According to the World Bank, Brazil is not beyond its acceptable threshold for this ratio. The World Bank's threshold is 50% of GDP for the external debt. However, in all other ratios above cited the country has fallen short of international acceptable thresholds in 2003. Brazil's total external debt/GDP ratio is about 300%, which is above acceptable international thresholds of 275%, or 250% for the rating agency Moody's. Brazil's debt principal payments/GDP ratio is over to 40%, which is beyond the international threshold of 30%. As for the debt interest payments/exports ratio, it is 22%, above the 20% threshold. Also Brazil's total gross public debt is around 78%, way above the international threshold (35%)for a developing country with high interest rates. However, all these ratios have improved lately, and in 2005 it is estimated that only the public debt threshold will not be met.

When analyzing these indicators, one can easily realize that Brazil is highly indebted, and for that reason it urgently needs to improve its various accounts. The Brazilian government is aware of this pressing need, and has been working to improve the county's debt situation. However, Brazilian debt management has not been given the stress it should have had, by both the government and society. The government has made substantial improvement in decreasing its short-term external debt. It has also managed to decrease Brazil's net public debt lately, to around 57% of GDP, down from 58% last year. Annual public debt balance was down to 3% in 2003, from 10% in 2002. These numbers should improve with projected GDP growth, interest rate fall and high increase in exports, as the trend indicates.

In what concerns trade, the Brazilian economy is still very closed. Brazil's exports represent only about 13% of GDP, and its imports only about 9%. So trade in both ways amount to about 22% of GDP, which is a very low number for international standards. Both in Mexico and in China, trade in both ways (exports + imports) represents over 60% of GDP. Having a high ratio of imports/GDP is also important, for the higher it is, the more room for adjustment of the current account, in case of a capital account crisis, the country has. A small percentage decrease on imports improves substantially the country's current account if it has a high imports/GDP ratio. In this sense, Mexico, which imports about US 245 billion, around 40% of its GDP, is much better perceived than Brazil by the international community. This helps Mexico be rated better than Brazil, as investment grade. Brazil has yet to become aware of the importance of having trade grow in both directions.

Apart from improving its debt position, Brazil has to address several issues in order to create a more favorable investment climate. The most important and urgent problem to be solved is what regards the respect for the rule of law and the enforcement of commercial contracts and business rights. Without this foundation, individuals and institutions will not thrive in the country. Brazil is known to have a judiciary system that works reasonably; it is in a medium position in an international scale of comparison. It is too slow and it does not protect property rights adequately. The system allows for corruption, and performance at work is not encouraged, as judges are not paid according to their professional achievements, but instead have fixed earnings. However, the current government has set as a top priority to reform the judiciary system. It has even created a special secretariat for judiciary reform at the Ministry of Justice.

In short, Brazil's judiciary is dysfunctional: agonizingly slow, beset with frivolous cases designed to evade justice and enmeshed in useless procedure. The 16,900 judges seem old-fashioned, out of touch and unaccountable to the citizens they serve. All this drains Brazil of money and morale. Armando Castelar, an economist, concluded from a survey of businessmen that GDP growth is a fifth lower than it would be if Brazil's judiciary were up to first-world standards.

Other challenges for Brazil refer to its infrastructure. Many years of tight fiscal policy have left Brazilian transportation, port, energy generation infrastructure in poor conditions. Roads must be improved and expanded. Railways and waterways are not very popular and must be built to allow for lower transportation costs, specially from the vast productive interior of the country, where most agricultural products for export come from. Some important projects are being executed, such as the works of the North-South railways, which crosses the country throughout in its highly dynamic interior. Yet, the country needs a lot more investments in transportation, which are not happening. Energy generation is a delicate area that has fallen short of investments lately. This is a key area for development, since economic growth increases energy consumption enormously. What's more, hydro-power plants take at least 4 years to start generating energy, so investment must anticipate consumption growth by many years. Brazil has not succeeded in attracting the necessary amount of inversions in this area. Ports also represent another infrastructure gap in Brazil. Their modernization and expansion are essential at a moment when Brazilian exports are expanding rapidly. The public-private partnership initiative the government is implementing now is trying to solve these infrastructure investment problems. Yet, no major project has been put in place as result of this partnership so far.

Brazil has made important progress in terms of political, financial and economic stability in recent decades. The country has been able to consolidate itself as a democracy, recently electing an ex-metal worker as president, Luiz Inacio Lula da Silva. At the same time, inflation has been under control for a decade. The financial system, after been reformed in the Cardoso government in the late 1990s, is considered sound.

Socially, Brazil is a true example of social integration, where all ethnicities and races co-exist peacefully. Despite the fact that our work force has relatively low education, barely 5 years on average, the immense young Brazilian population is becoming highly educated, with 97% of children now enrolled at school. Since the country has a predominantly young population, in a near future workers will be sufficiently educated, which should help improve the investment climate tremendously. Furthermore, in the last decade, a vast social safety net has been weaved. Universal health is available countywide, so is malnutrition combat programs. Brazil still lacks programs of retraining and placement of workers hit by the churning of firms as a result of structural changes in the economy, due mainly to the third wave of globalization.

In what concerns the current account, it has become positive in 2003, by 0,8% of GDP, and should show similar result this year, which confirms a sustainable trend of positive results. Exports has been helped by rising commodity prices, but the positive performance is also the result of the new stress the country has been given to export promotion. Brazil has become the biggest export of items as diverse as soybeans, beef, poultry, ethanol, and medium-sized airplanes. It also should export around US$ 6 billion in automobiles in 2004, and is a big exporter of buses and transportation machineries in general. Due to the diversification of the industrial park, its diversified exports have allowed for Brazilian terms of trade (price of exports/price of imports) to improve in recent years.

However, manufactures represent a lower percentage of Brazilian exports (about 70%) than they do in most new globalizers, such as China (over 80%). This does not mean Brazil is lagging behind, but it should be explained partly by the extraordinary competitivity of Brazilian agriculture, which makes agribusiness responsible for 42% of the total exports. Most of it is processed, but a large chunk is not, specially due to protectionist practices of importers, who impose higher tariffs in processed foodstuffs than in primary unprocessed products. Brazil also faces severe barriers in beef, sugar and orange juice on the part of the United States. Apart from that, Brazil's immense comparative advantage in most agricultural products is distorted by subsidies and quotas, specially by the ECC countries, Japan and the United states. For that reason, President Lula has made a priority of his administration to set forward a new round of negotiations aimed at removing the barriers that prevail free trade in agriculture. To achieve that, Brazil has led the creation of the G20, a group of major developing countries and some developed countries that demand change in agriculture trade practices that distort commerce worldwide.

Brazil is competitive in several fields. The sectors at which it presents highest competitivity are textile, footwear, steel, agriculture, and fish products. It is also competitive in aeronautics. In an eventual realization of FTTA, these should be the areas in which it can increase its exports.

Brazil has surprised the world when it recovered quickly from its currency devaluation in 1999. Unlike South Korea, which underwent a deep recession in the aftermath of its devaluation, Brazil managed to experience even a small GDP growth in 1999. There are some reasons behind the Brazilian resilience. One is that unlike South Korean companies, which were highly indebted in dollars, Brazilian companies were not. Another reason is the spectacular competence of Brazilian agribusiness, which has arisen as one of the most competitive in the world. So much so that the UN has projected that Brazil will be the biggest agriculture producer by 2015, up from the forth position it holds nowadays.

For that reason, when assessing Brazilian investment perspectives, one must take into account the Brazilian agribusiness success story, for it show a lot about the country's potential. Newsweek International has recently published an article that tells the story. The article is reproduced in full down bellow.

The country is planting its once arid frontier and fast becoming an agribusiness titan
By Mac Margolis, Newsweek International

Feb. 23 issue - It's not yet noon in Mato Grosso state, but already the tropical sun presses through the clouds like a steam iron. This is Brazil's far west, a flat, featureless expanse at the bottom lip of the Amazon basin. The mercury is pushing 40 Celsius, but the 100 or so

people gathered today on a simmering stretch of fresh asphalt seem hardly to notice. They have come to get a glimpse of MT-449, the newest Brazilian highway. It's just a patch of tarmac, but don't tell that to the residents of Lucas do Rio Verde, a bustling farm town in the nation's biggest grain belt. Just getting their produce to market used to mean an epic journey over dirt tracks that melted away every rainy season. Now they bow their heads and give thanks while a priest spritzes holy water on the immaculate concrete. "This highway," says Mayor Otaviano Pivetta, with a sweep of his hand, "is redemption."

Brazil might well say "Amen." Lucas do Rio Verde arose from the dust 25 years ago when the government dispatched legions of farmers from the overcrowded South to the empty western outback. The settlers hacked down the scrubby forests, or cerrado, only to find weak and acidic soil. The heat was hellish, and the rains came in deluges. Malaria was rampant. One by one the farmers failed, some swapping their lots for nothing but a *ride back home. But the few who hung on eventually prospered-and turned this drowsy village-into an agricultural boomtown. Now an empire of soybeans stretches from horizon to horizon.*

It's more than a handsome vista. Here, in the cerrado of Mato Grosso, and radiating out through the Brazilian backlands, the frontier is dotted with hulking silos, computerized harvesters and plantations the size of townships. With the help of clever agronomists, modern technology and the callused hands of pioneers in scores of towns like Lucas, Brazil has become the world's newest agricultural superpower. Last year, while the national economy struggled, Brazilian farmers reaped another bountiful harvest of commodity crops. Grain production, for example, topped 123 million tons - double the figure of a decade ago. While Brazil's overall jobless rate spiked to 8 percent last year, rural employment grew by 6.5 percent, and 10 percent in the frontier states of Mato Grosso, Tocantins and Goias.

Brazil has long been a powerhouse producer of coffee and sugar. But now the country's farmers and agribusinesses are extending their global reach, grabbing market share with new crops and lapping the competition in industrialized farm goods like orange juice, alcohol, tobacco and leather hides. Led by the cerrado pioneers, Brazil in 2002 surpassed the United States as the world's largest exporter of soybeans, soybean oil and soybean meal. In addition, the country recently became the world's largest exporter of beef, passing Australia.
And while quantity is important, so is quality. Brazil's cattle herds eat only grass and soy meal, not feed made from ground-animal parts that some experts suspect is responsible for the spread of mad-cow disease. Agribusiness now accounts for more than a quarter of the country's $600 billion gross domestic product, and employs around 20 million people, roughly 37 percent of Brazil's total work force. "Brazil has technology, sunlight and a huge empty frontier," says Amaryllis Romano, an agricultural analyst for Tendencias, a Sao Paulo financial consultancy." The result is now explosive growth."

With farm output swelling at nearly 6 percent a year, some Brazilian experts assert that the country could someday overtake the United States as the world's biggest agricultural producer. That won't happen any time soon: Brazil is a distant fourth as an agricultural exporter. But few farmers anywhere can match the country's productivity. Unlike in India and China, where low-tech, labor-intensive family farming is still widespread, Brazil employs the latest technology and modern methods, especially low-tillage planting-sowing fields without turning over the earth, so as to avoid soil erosion. Unlike most countries, Brazil also has plenty of virgin land left to plow-some 80 million hectares, or an area the size of Britain and France combined.

Brazilian farmers say the only thing that can slow the country's emergence as a farming superpower is protectionism-the barbed-wire fence of tariffs, red tape, sanitary restrictions and subsidies that encircles the United States and Europe. No wonder the country's diplomats are walking into trade parleys these days with a cowboy glare. "Agriculture has always been taboo at the major trade summits," says Marcos Sawaya Jank, an agricultural trade analyst who keeps close counsel with Brasilia. "Brazil wants to change the rules."

Indeed, a major food fight has already begun. Brazilian President Luiz Inacio Lula da Silva has made agricultural-trade liberalization a key policy objective for his administration-and the casus belli of the G20, the klatch of developing nations he mustered to challenge the rich world's agricultural subsidies. Brazilian trade negotiators have taken the EU to task at the World Trade Organization for its subsidies for sugar exporters, and filed a complaint against the United States for its soaring surtaxes on imported cotton. Not coincidentally, two of Lula's most trusted advisers are Agriculture Minister Roberto Rodrigues, himself a farmer, and Trade and Development Minister Luiz Furlan, who owns one of the continent's biggest meat-packing businesses, Sadia.

Brazil was not always so ambitious. For the first four centuries after the landing of - Portuguese explorers, the country lived with its back to the wilderness. Generations of settlers were content to scratch out a living "like crabs," as the colonial historian Frei

Vicente do Salvador once wrote, along the narrow Atlantic seaboard. Many dreamed of returning to a golden retirement in Portugal. Many more feared the serto, the vast outback, with its feral beasts, unknown Indian tribes and the killer heat of the tropics. In time, with the population growing, and word spreading of riches to be found in the forests, people began to venture west and north, all the way to the Amazon rain forest. But it was the cerrado-the sprawling stretch of savanna, scrub and squat forest in western Brazil-that caught their attention, and that would become the New World's most unlikely breadbasket.

While Brazil is blessed with good weather, the country's hot climate can also be a curse, cooking crops and setting loose all types of plant diseases. It took three generations of trial and error, but farmers, scientists and entrepreneurs defeated nature's resistance. Much of the credit goes to EMBRAPA, the government agricultural- and cattle-research institute, where painstaking experiments with plant genetics and organic pest control have pushed the farming frontier all the way to the equator.

One of the research institute's early coups was adapting soybeans, a temperate-climate crop originally from China, to the tropics. With new tropicalized soy seeds, Brazil turned the steamy cerrado into a garden, growing two crops of soy a year, plus a fallow crop of corn in between, against a single crop for Northern Hemisphere growers. Such success has turned Embrapa into an oracle of sorts for developing nations, which are home to two thirds of the world's population and three quarters of its hungry. Hardly a week goes by without officials from Asia, Africa and Central America calling on the institute for advice, seeds and farm technology-a growing Brazilian export.

EMBRAPA has done a lot with little money. As a government agency, it's hampered by Brasilia's chronic budget shortfalls. Telephones at EMBRAPA branch offices often fail to work, and underpaid researchers have to scrimp and beg for funds for field work. EMBRAPA cattle expert Judson Valentim has taught a generation of ranchers in the western Amazon basin how to triple their herds without cutting down a single additional *hectare of rain forest. But he does it on a shoestring. "Whenever there's an economic crisis," laments Valentim, "agricultural research suffers."*

In the 1970s, when the military ran Brazil, agriculture was a protected industry. But the policy failed. "It was a copy of U.S. farm policy," says Jank, "but without the money to back it." A decade later, with Latin America immersed in a debt crisis, Brasilia ended its farm-subsidy program and threw open the country to world competition. Suddenly, the farmers, herders and agro-industrialists were on their own.

Fortunately, by then a solid decade of public investment in farming technology came onstream. Major private investors like Cargill, Bunge and the Brazilian soy mogul Blairo Maggi (now governor of Mato Grosso) also contributed. As government largesse evaporated, private-sector investors stepped in, investing heavily in food processing, transport and infrastructure; the combination helped turn Brazil into one of the world's most competitive farming economies. "Agriculture has managed to absorb technology and investment in a way that other sectors have not," says Brazilian Finance Minister Antonio Palocci. "This is a model for the rest of the economy."

For all its modern vitality, the Brazilian countryside is not an unblemished landscape. Among the gleaming silos and air-cooled tractors, bitter poverty and brazen cruelty can be found. Late last month four government labor inspectors were murdered in an ambush as they were investigating the alleged enslavement of farmhands by rural landlords in southeast Brazil. Brasilia reckons that some 180,000 farm workers are being treated inhumanely (subjected to many hours of work, often without pay or benefits) on ranches throughout Brazil. But that is not the rule. Where modern farming methods have been established, labor has become more and more specialized, and the workers better paid. Whereas Brazilian per capita income has been flat for more than a year, rural wages grew 6.9 percent last year.

Ironically, Brazil's farming success has been achieved largely without genetically modified crops. Commercial GM plots are still technically illegal-though scores of *farmers grow them everywhere in Brazil. A huge row between environmentalists, farmers and big agribusiness has split Lula's government. Last month Brasilia hedged its position on the issue: the government opted to keep the GM growing ban in place but allowed farmers to sell their bootleg crop anyway, at least until a panel of experts gives the final verdict on the health and environmental hazards of biotech crops.*

Meanwhile, Brazil's agronomists have quietly developed an array of Experimental GM crops, from cotton to papaya, that will yield disease-resistant strains of food and farm goods that could substantially boost exports-if agricultural protectionism, and resistance to GM foods in Europe, ever fades. Whatever happens, Brazil's bountiful farming revolution is still in an early stage. That is good news for Latin America's biggest economy, and bad news for its competitors.

To sum up, in order for Brazil to optimize its gains from globalization, it should place great effort at improving its debt situation, and work hard to improve its investment climate. This means that the pension and tax systems reforms have to be deepened in the future. Public debt has to be further structured, so as to continue to increase its maturity at the lowest interest rates possible. The judiciary must in fact be quickly and well reformed, so it can work with the necessary rapidity, guarantee property rights and protect creditors against default on their loans, by allowing them to swiftly seize property to recover their investment (which can contribute greatly to interest rate reduction, and as a consequence, public debt reduction and economic growth).

6. Conclusion

Has globalization helped low-income countries reduce poverty or perpetuated international inequality?

Globalization, which is about economic and social integration among countries, has been going on for a long time (since the dawn of human history), but the speed of contemporary communication and travel makes the current round of globalization a novel. People around the world know a lot more about each other than ever before, a sense of global community is developing. Globalization is not an even process. The rich countries are mostly progressing at a very gradual rate. An interesting thing is that about half the developing world is integrating very rapidly with the world economy, and this is where we see the fastest growth and poverty reduction in the world. Examples are China, India, Vietnam, Chile, Mexico, and Uganda. On the other hand, about half the developing world, comprising mainly Sub-Saharan countries, hardly seems involved at all. While integration creates potential opportunities, poor people cannot take advantage of these unless they have education and access to assets such as land and credit. Many poor people are left out of globalization because their governments are not providing these basic services.

Globalization is like a fast train and to get on the train countries need to "build a platform." By that it is meant a foundation of good rule of law, basic education and health for the people, reliable infrastructure of transportation, telecommunication, port, energy, and the like. Where this foundation is weak and there is a really corrupt, incompetent government, it is very hard for any positive result of integration to take place.

It is as President Fox of Mexico stated, to take advantage of globalization, developing countries "need to do their homework." By "homework," he means creating a good environment of property rights and rule of law, as well as educating people and providing sound infrastructure. It is also important to promote macroeconomic stability and hold debt at prudent level. The developing countries that are "doing their homework" are benefiting from globalization in terms of faster growth, more job creation, and better lives for their people.

The Chinese call their reform movement "gai ge kai fang," which loosely translates as "change the system, open the door." Clearly the Chinese think that opening the door is a critical input to their development. The increase of their trade has been extraordinary; they are the largest recipient of direct investment in the developing world; and large numbers of students have gone abroad, and then many returned home. It could be argued that these different aspects of globalization have all been very important for China's rapid emergence as a global economic power.

Worldwide inequality was on the rise for more than 100 years, up to about 1980. Since 1980 there has been a modest decline in worldwide inequality, because the fastest growth in the world has occurred in countries such as China and India that were quite poor 20 years ago. The 1990s was the first decade in which the developing countries as whole grew at a faster rate than the rich countries. That trend is likely to continue. Within countries, some countries have seen higher inequality (such as China and the U.S.), but in other countries inequality has declined, and in many countries it has been quite stable. The important fact to notice is that the emergence of China and to a lesser extent India is an important new phenomenon in the world. If the current trends persist, these will be the two largest economies in the world by mid-century

Integration with the global economy has costs and benefits. There is no question it will destroy some jobs and encourage firms and workers to move to new activities. The evidence is that integration creates more jobs than it destroys and that in developing countries it can spur fast growth and poverty reduction. The most dramatic poverty reduction in the past 15 years has been in countries that deepened their integration with the world market – examples are Bangladesh, Vietnam, China, India, and Uganda. With the faster job destruction and creation, it is important to have effective safety nets to help people make the transition. In short, globalization can be "win-win" for developing and rich countries alike.

In assessing a country soundness of its institutions and policies, its investment climate, a good diagnosis can be made by looking at the Informal economy. It exists in all countries, but the extent of it varies, and it should be taken as a good indicator of whether or not a country has sound, workable institutions and policies. In the right environment, lots of small and medium formal enterprises will emerge. With a highly distorted environment - excessive regulation, burdensome corruption, non-functioning infrastructure - everything remains informal, which keeps it at a small scale. Just about everyone remains poor. So, it can be said that the distortions that generate a large informal economy are constraints to benefiting from integration.

Since most developing countries of the South are highly competitive in agriculture, and the rich countries of the North have put together the highest arsenal of barriers of all sorts possible against agricultural products, a new round of negotiation in this area at the WTO aiming at establishing fair trade rules for agriculture is mandatory. A way to achieve that is to rally NGOs, consumers, and other groups to bring down agricultural subsidies and other barriers of rich countries. This would create more trading opportunities for poor countries and raise the incomes of their farmers. The anti-globalization movement has created the false impression in rich countries that trade is a bad thing for poor countries and poor people so that it is harder to rally groups to support efforts that make it easier for poor countries to trade. Activists who care about the poor in the developing world should be trying to make it easier - not harder - for them to access US and other rich markets.

Free trade in agriculture would greatly help globalization to succeed. It would encourage many developing countries to open their markets of industrialized products to rich countries, so as to foster trade. Furthermore, rich countries would gain efficiency by optimizing their allocation of productive resources, and consumers in these countries would improve their standards of living by consuming healthier and cheaper food. Subsidies that are today given to agriculture could be channeled to stimulate environment protection, or to other needy areas such as public health care. In short, the whole world would gain.

Isolationism does not seem to be an intelligent strategy. Developing countries influenced by dependency theory tried to develop in isolation throughout much of the 1960s and 1970s and the results were not very good. Global poverty continued to rise throughout this period. Led by China and India, the developing world has shifted its strategy toward one of integration, and that shift seems to be paying off (the number of absolute poor in the world has been declining since about 1980).

Developing countries should be more pragmatic and forget old prejudices against Multinational Corporations (MNCs). In the past decade, fortunately, most developing countries have shifted gears, recognizing that MNCs can be useful in terms of bringing new technology, marketing networks, and job creation. In small countries there is some risk that MNCs will exercise undo influence over government policy, whereas in large countries such as China, Brazil, India, and Mexico that governments have been able to solid frameworks that push MNCs to fit into the country's development strategy. Since a big chunk of trade and technology transfer is intra-firms, a friendly environment where they can operate is key in a successful country trade policy strategy. For example, 12% of exports from China to the United States are done by Wal-Mart.

Some amount of social capital is useful for taking advantage of globalization. Low-income countries do not always lack social capital. Twenty-five years ago China and India were poorer than Sub-Saharan Africa and had about 70 percent of the world's extreme poor (living on less than $1 per day). Both China and India have benefited very powerfully from integration with the global economy; they combined their good institutions and social capital with more open policies that stimulated rapid growth and unprecedented poverty reduction. There are other low-income countries that have had impressive growth and poverty reduction, fueled in part by globalization: Bangladesh, Uganda, and Vietnam are examples. But clearly many low-income countries have poor institutions and governance and are not participating very much in or benefiting very much from globalization**.**

In conclusion, the development of a good investment climate is the key for a country to successfully integrate in the world market, and to fully take advantage of the growth opportunities unveiled by the third wave of globalization. And they are plenty. Accordingly, developing countries should work hard to promote the health and education of their population Also it is imperative they build a sound infrastructure, comprised of ports, roads, railways, waterways, telecommunications, customs administration, rule of law, property of rights enforcement, customs administration, among others. Apart from that, political, financial and economic stability must be searched by all means. The highly indebted countries of Latin America has an extra challenge: to bring down their public debt as well as their accumulated external debt (public + private) to levels the international markets feel there is no risk for the countries to default on their obligations.

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