

Book Review

Ramkishan S. Rajan, *Economic Globalization and Asia: Essays on Finance, Trade and Taxation*, New Jersey, London, Singapore, Institute of Policy Studies and World Scientific, 2003, pp. xi + 257, ISBN: 981-238-389-1.

In the *blue corner*, proponents of globalization – defined loosely here as the increasing economic integration worldwide – argue that opening the domestic economy to the global market will maximize globalization benefits since, in a highly protected economy, the scale of operations is small, competition from international markets is absent and, as a result, rent-seeking activity is pervasive. The closed economy leads to inefficient utilization of resources and to minimal incentives for innovation. In contrast, there are manifold channels for a country to gain from a globalized economy, ranging from technology transfer and foreign investment (spillover effects) to competition and regulatory stability. Globalization expands international and domestic markets, introduces competition, and reduces transportation and production costs. This will increase efficiency and expand production that in turn will benefit workers.

The reduction in domestic protection and removal of price distortions as a result of globalization encourage exports and, at the same time, discourage resources from going into import substitution industries. This will facilitate growth of real exports, leading to overall growth in the economy. In this sense, an open economy is always better than a closed one, especially in the long run (Winters *et al.*, 2004). Open market and free trade in this context act as growth engines, generating higher economic activity, which should be translated into better living standards and shared prosperity for all, including the poor. This pro-poor view of globalization has been strongly advocated by the World Trade Organisation (WTO) as can be seen from its continuous call to developing countries (DCs) to embark on trade liberalization as a way of reducing poverty.

There is increasing awareness of the advantages of economic policies favouring openness and export orientation that can be seen from the major shift in the economic policies of many DCs away from inward-oriented, import-substitution to outward-oriented, export-led growth policies. This change, to some extent, reflects dissatisfaction with the results of previous import substitution policies (in the previous decades) and the desire to emulate the strong growth performance of the outwardly oriented, new industrialized countries (Edwards, 1993; Krueger, 1998). Dornbusch (1992) further elaborates four overlapping sources of the enthusiasm for free trade:

anti-statism, poor economic performance of import substitution policies, more widely available information, as well as World Bank (WB) pressure and evidence of the success of open economies. In the 1990s, for instance, the top one third of developing countries that actively integrated with the global market grew at about 5% per capita, while the rich countries grew at about 2% and the rest had negative growth (Dollar & Kraay, 2001).

In the *red corner*, opponents of globalization think that its effects could go either way depending on various aspects, such as the existing structure and levels of international trade taxation along with other economic policies, structure and rigidities. Bringing in the global market can result in business closures, unemployment and skewed income distribution. Furthermore, many globalization impact assessments are based on per capita assumptions, while the actual impacts on different household groups are quite varied and not always positive, especially considering the spending and earning effects of globalization. From a sectoral perspective, most heavily protected sectors in DCs, including in Asia, tend to be sectors that employ a high proportion of unskilled workers earning low wages. Accordingly, it should not come as a surprise if globalization has a negative impact on unskilled workers, especially in the short and medium run. This is in addition to the reasons discussed in the book, stemming from global finance, trade and taxation. The adverse impact is further strengthened by the lack of major labour reallocation across sectors (quantity effects) following globalization (unlike in the first wave of globalization, see Chapter 1 of the book). Price and wage responses are more pronounced than the quantity response, indicating market rigidities in DCs that increase the likelihood of globalization's adverse effects on the poor. Opponents of globalization and free trade also raise some concerns over the human or labour rights issue, since the search for maximum profit by multinational corporations could drive workers into a 'race to the bottom' for lower wages and poor working conditions (not to mention other impacts such as endangering the environment and even compromising national sovereignty).

In a nutshell, the effects of globalization are uncertain. Globalization always creates winners and losers and the notion that the 'rising tide will lift all boats' can be very misleading. One cannot just regard the proponents' view as a 'global phobia' (see pp. 14–15 of the book for additional reasons why).

And *the winner* is . . . inconclusive!

It is reassuring to find that the book is not trapped in the dichotomy of the blue and red corners above. Both positive and negative aspects of the many globalization issues chosen for discussion in the book are examined in an objective manner, avoiding the right and left views of political economy.

The main contribution of the book is in providing a concise, systematic and objective summary of the complicated issue of globalization. The author is very aware of this by choosing to concentrate on economic globalization with a specific focus on Asia. The three main issues of economic globalization chosen for examination in the

book – monetary and finance, trade and tax – are discussed from a reasonably objective and balanced perspective, especially in relation to both their benefits and costs to the economy.

The book has four parts. Each chapter within the four sections has a conclusion, which makes it easier to read each chapter and section independently.

The first part introduces the issue of economic globalization for small and open economies in Asian countries, by highlighting the three aspects of finance, trade, and taxation. The role of finance and capital flows, agglomeration and fragmentation, first and second waves of globalization, and public finance and income distribution are discussed and put into perspective.

The second part of the book discusses international capital flows and contagion, monetary cooperation, and exchange rate policies. The regionally contagious nature of the currency crisis provided additional reasons for regional financial and monetary cooperation, including a role for the IMF in this context. On exchange rate policy, the dilemma of ‘to float or not to float’ is still pertinent today, including the issue of introducing different methods of currency band. Meanwhile, the search for the most appropriate exchange rate policy continues.

The book’s third part examines the real sector of trade issues such as the effects of trade liberalization on income (growth) and poverty. The more specific cases comparing India’s trade reform with that of its Asian neighbours, the regional trade pact of Singapore, and the international trade in services are also considered. Some important issues concerning the effects of trade liberalization on income and poverty are discussed, including effects within the rural and agricultural sectors. Trade liberalization can be ‘growth stunting’ or ‘growth enhancing’, which can only be determined empirically. If concern for the poor is taken into account explicitly, the trade liberalization effects become even more complex.

Comparison of India’s trade reform with that of East Asian countries, and the emerging of services trade in India, further highlight the important strides that India has made since its reform programme began in 1991 (even though some authors have argued that the reform was actually started earlier). India has left behind the ‘Hindu’ growth to embrace the post reform ‘boom’.

The final part of the book explores globalization and taxation with special reference to Southeast Asia. Economic globalization has made it increasingly difficult to tax the full range of economic activities, making ‘fiscal sustainability’ difficult to attain.

Given the coverage of the book, one might wonder about the choice of issues discussed and cases selected. Certainly the book does not cover comprehensively the broad sweep of issues concerning globalization, nor does it offer global geographic coverage. It is not intended as a handbook of globalization. There is nothing wrong with this approach, of course, for it has a lot to do with the author’s interest and previous work. The problem is that some consumers always demand more and it is difficult for these consumers ever to be fully satisfied. In this context, one might expect that a sequel or further edition of this book might be a good idea, including

other issues and more coverage and updating of the recent developments concerning issues discussed in this volume.

In this regard I would like to draw attention to the effects of trade liberalization especially on poverty, which is discussed only relatively briefly in the book. The 'best practice' of trade liberalization includes replacing quantitative restrictions with tariffs, simplifying the tariff structure, broadening the tariff base, levying lower and more uniform tariff rates, and exempting or reducing tariffs on intermediate inputs. Removal of quantitative restrictions avoids rent seeking activities, a simpler tariff structure is easier to administer, a broader tax base yields larger revenues, a lower and uniform tax rate reduces unintended distortions (and is also easier to administer) and exemptions/reductions on intermediate input taxes encourage domestic production. Other common measures include simplification of import and export procedures and unification of multiple exchange rates, which act as implicit taxes on exports.

Empirical evidence shows that at a global level multilateral trade liberalization always produces winners and losers. The effects of the People's Republic of China (PRC) accession to the WTO provide a clear example of how benefits to one country (in this case PRC) are always attained at the cost of benefits to others (OECD and other Asian countries). A study using macroeconomic data from almost 100 countries in the period 1960–98, when around 60 of these countries acceded to WTO, reveals that the benefits of trade liberalization are not clear, not particularly large, and vary considerably across countries, depending on their characteristics (Li & Wu, 2002). Moreover, trade liberalization without structural reform can have serious adverse effects in transition and developing economies. The results of unilateral trade liberalization across countries also give no definite conclusion. In a more comprehensive way, Winters (2000), Bannister and Thugge (2001) and Reimer (2002), emphasize that factor markets are perhaps the most important linkage between trade and poverty, since households tend to be much less diversified (more specialized) in income than they are in consumption. Moreover, details of potential links between trade liberalization and the poor are more complex, including changes in (i) price and availability of goods; (ii) factor prices, income, and employment; (iii) government transfers influenced by changes in revenue from trade taxes; (iv) incentives for investment and innovation, which affect long-run economic growth; (v) external shocks, in particular changes in the terms of trade; and (vi) short-run risk and adjustment.

The trade liberalization effects on poverty will never be a static, one-to-one mapping, but will go through a dynamic process involving commodity and factor markets. In the process, all are influenced by various policies affecting the markets and by the behaviour of the economic actors and institutions. Trade liberalization will first affect a government's income and the prices of import, which has repercussions for the whole economy, including the poor. From the government side, the initial reduction in revenue as a result of trade liberalization can impact variously upon the economy, depending on how the government reacts to the revenue cut in its fiscal and industrial policies. From the commodity side, trade liberalization lowers domestic prices for

imported products, increasing intermediate and final demands. Households benefit from the lower prices for their final demand (i.e. commodity price effects) but they could be worse off due to wage and other quantity effects. The latter effects depend on the 'dynamics' of the domestic supply response and the household's position as a supplier of labour and capital in the factor market. This should be examined in the context of the existing (and the incoming) domestic industry (both as substitutes and complements to the industry that is liberalized). Accordingly, the end result of trade liberalization cannot be determined beforehand without imposing some strong assumptions. Trade liberalization can raise real incomes and reduce poverty by lowering prices of imports and import substitutes consumed by the poor or by raising prices of exports or import complements produced by the poor (Brooks, 2003). Overall, at least three aspects make the end result always ambiguous: the heterogeneity of poverty, the specific trade reform measures undertaken and the economic environment (Winters *et al.*, 2004).

The already complicated effect mechanism discussed above also ignores other factors such as political economy and sustainability, for trade liberalization inevitably increases 'foreign' influence, which has good and bad effects on the country. There are also other aspects that are not well understood but have significant impacts and policy implications, such as timing and sequencing. This includes questions as to whether trade liberalization should be conducted before capital account liberalization and if it should be approached in a 'big bang' or gradual manner. Each of these options will have very different impacts on the economy, further complicating the effects of trade liberalization.

The discussions above suggest that there is a strong argument that trade liberalization effects are country specific, depending on the economy in question. Trade openness does not have systematic effects on the poor (Berg & Krueger, 2003) and tracing the links between trade liberalization and poverty is detailed and generally very case-specific work (McCulloch *et al.*, 2003).

One thing is for sure about trade liberalization: it remains an unfinished business for governments in both developed and developing countries, although for very different reasons. Market protection in developed countries is mostly political while governments in DCs have different agendas concerning the government revenue and the classic infant industry argument. Complementary policies that directly address the poor are always needed.

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*The views expressed here are those of the author and do not necessarily reflect the views and policies of the Asian Development Bank, the Board of Governors or the governments they represent.

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