Lowy Institute Paper 18

second thoughts on globalisation

Mark Thirlwell

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CAN THE DEVELOPED WORLD COPE WITH THE RISE OF CHINA AND INDIA?

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Executive summary

At the heart of most economic or business scenarios is the assumption that globalisation will continue to be the dominant force shaping the world economy. Sometimes, as an extreme alternative, the possibility of a large-scale collapse of the process is also canvassed. The most likely alternative to the business-as-usual scenario, however, is for a change in the nature of the global policy environment to one that is less globalisation-friendly, such that instead of simply facilitating ever deeper international economic integration, policy tries to either slow or modify the process.

The probability of such a policy shift is now on the rise, as significant parts of the developed world seem to be having second thoughts about the benefits of globalisation. Most, but not all, of these second thoughts relate to the implications of the globalisation-powered rise of China and India. Some are scared by the success of globalisation in creating powerful new competitors in global markets or spooked by the security implications of the resultant shifts in economic power. Others are ill at ease with increases in inequality and troubled by the implications of expanding trade ties with low income economies. Yet others are nervous about the consequences for the environment and resource security of the industrialisation and urbanisation of the world's two most populous economies. Meanwhile, the international institutions whose job it is to oversee this new global economy look increasingly uncomfortable in their role.

The combination of forces driving globalisation remains powerful and a change in policy direction is not a done deal. Technological advances in transport and communications, and the self-sustaining effects of past deregulation and liberalisation will continue to be important forces driving integration. Even so, there is a growing probability that in the future policymakers in the developed world will be more inclined to pursue policies that help temper or modify these forces, rather than reinforce them.

There are four important issues to track this year that will provide a useful reading on the policy mood. These are: the state of the Doha round of world trade negotiations; the response of the US Congress to the request to renew the President's Trade Promotion Authority (TPA); the path of US-China bilateral economic relations, including the follow-up to May's Strategic Economic Dialogue; and Beijing's efforts to modify the Chinese economic model to take into account the protectionist backlash it is now triggering in the rest of the world. Developments on these fronts should provide a useful guide as to the seriousness of the pressures to rethink globalisation-friendly policies.

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List of acronyms

ASEAN	Association of Southeast Asian Nations
ASEAN + 3	ASEAN, China, Korea and Japan
CDM	Clean Development Mechanism
CEO	Chief Executive Officer
CNOOC	China National Overseas Oil Company
CO2	Carbon Dioxide
EAS	East Asian Summit
EIA	Energy Information Administration
EU	European Union
FDI	Foreign Direct Investment
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IEA	International Energy Agency
IMF	International Monetary Fund
IPCC	Intergovernmental Panel on Climate Change
IT	Information Technology
MTS	Medium Term Strategy
OECD	Organisation for Economic Cooperation and Development
PTA	Preferential Trade Agreement
SED	Strategic Economic Dialogue (between China and United States)
TPA	Trade Promotion Authority (formerly known as 'Fast Track')
UAE	United Arab Emirates
VER	Voluntary Export Restraint
WTO	World Trade Organization

Chapter 1

A global policy shift in the offing?

At the heart of most economic or business scenarios is the assumption, either explicit or implicit, that globalisation — here defined narrowly as international economic integration — will continue to be the dominant force shaping the world economy. Whether the focus is on future growth markets for consumer goods, prospects for financial market returns, or even the evolving distribution of (economic) power in the world economy, the standard base case is for globalisation to be sustained. Sometimes, as an extreme alternative to this business-as-usual outcome, the possibility is advanced that a major geo-political shock could derail the process altogether, and parallels are drawn with the collapse of the previous age of globalisation brought on by the First World War and the Great Depression that followed.[1] Yet perhaps the main lesson to be drawn from the collapse of the nineteenth century version of globalisation is not that the process is vulnerable to a big enough geo-political shock — clearly it is — but rather that globalisation is a fairly resilient phenomenon. After all, then it took the potent combination of a world war and the economic meltdown of the Great Depression to kill it off.[2] The more likely alternative to the business-as-usual scenario is *not* that globalisation comes crashing to a halt, but rather that the policy environment becomes less globalisation-friendly in ways that attempt to slow or reshape the process, for example by insisting more rigorously on tougher labour standards or environmental requirements in return for enhanced market access.

Since the 1980s, governments, at first mainly in the developed world but increasingly in the developing world, have tended to foster policy regimes that have been broadly supportive of globalisation. This trend has been visible in moves to cut tariff and other trade barriers and to liberalise capital flows, for example. Of course, pockets of protectionism still exist, and in some sectors such as labour markets and agriculture, the barriers to cross-border movement are still substantial. Moreover, most empirical studies continue to find that distance in general and national borders in particular continue to have an important influence over trade and other flows.[3] One consequence of this is that much of globalisation has a distinctly regional flavour, of which more below. Nevertheless, the clear trend has been towards a reduction in artificial or policy-driven barriers to international transactions, creating a backdrop of a generally permissive policy environment for economic integration.

It is this globalisation-friendly policy environment that is now under challenge, mainly as a consequence of a re-evaluation of the distribution of the costs and benefits arising from globalisation on the part of some in the developed world. That re-evaluation has been prompted in large part by the economic integration into the world economy of China and India. It is also possible that a smaller role has been played by the failure of the international economic architecture to adapt to the new environment.

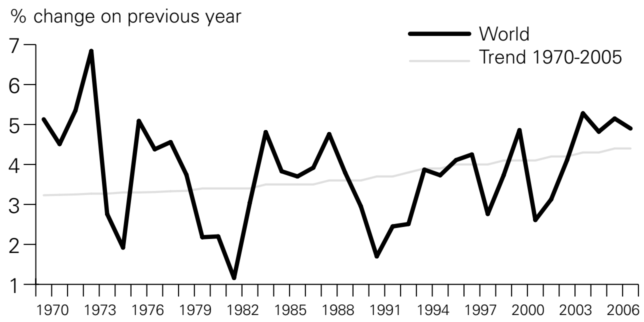
Chapter 2

Second thoughts on globalisation

At first glance, it might seem strange to be considering some sort of point of inflection for attitudes towards globalisation. If consensus forecasts remain on track, then 2007 is set to be another year of strong global growth, marking perhaps the best four-year performance for the world economy since the early 1970s. Other comparisons suggest that we are currently enjoying the strongest period of world growth since the Second World War. Meanwhile, globalisation has continued apace. The two developments are, of course, linked: globalisation is an important contributor to the ongoing rise in the world economy's trend growth rate, directly through the faster growth and rising share in world output of emerging markets, where growth has been boosted by international economic integration, and indirectly through its impact on productivity and support for a benign inflation environment (Figure 1). Certainly, globalisation has had some unpleasant side-effects, but taken overall, the macro-economic payoff has clearly been positive.[4]

Yet despite good times for the world economy, some of the foundations for globalisation are not as solid as they once were. Granted, many of the forces driving economic integration are still running at close to full throttle: the impact of technology-driven declines in transport and communications costs and the competitive pressures generated by the emergence of something closely approximating global capitalism both continue to tie national economies ever closer. Trade is still rising as a share of world output, and capital flows continue to surge around the globe. At the same time, however, there are signs of a shift in the policy environment. The painfully difficult process of reaching any sort of substantive agreement in the continuing Doha round of multilateral trade negotiations is one example of this phenomenon; others include the growth of protectionist sentiment in Europe and the United States, along with public and political concern about inward foreign direct investment and migration.[5] Moreover, if the global economic environment were to become significantly less benign, it is likely that these pressures would be greater. Similarly, if the world had to cope with a significant globalisation failure — a major financial accident seems the most likely candidate here — then anti-globalisation pressures would receive an even bigger boost. The key point of this Paper, however, is that it is currently the *success* of globalisation that is creating adjustment problems for the developed world.

Figure 1
World Real GDP Growth



Source: IMF World Economic Outlook September 2006

While developing countries have also been influenced by this shift — witness the re-emergence of resource nationalism and economic

SECOND THOUGHTS ON GLOBALISATION

populism in a number of emerging markets, for example — what is particularly striking about the re-evaluation of globalisation now under way is that the most heated debate is taking place in the *developed* world. Historically, much of the scepticism about the workings of the international economy came either from developing countries themselves, or from their perspective. Such critiques tended to be based on the assumption that the international economy was operating largely to the unfair advantage of the rich world and the detriment of the poor, producing the kind of calls for a New International Economic Order made in the 1970s and 1980s. Such criticisms can still be heard today, but they have been muted by the evident economic success of developing country giants like China and India. Instead, many of the loudest attacks on the consequences of globalisation are to be found within those developed economies which have been the architects and builders of the new global economy.

It is the developed world that is now having second thoughts about globalisation. Crucially, there now seem to be few votes to be had for rich country politicians in advocating more globalisation, in contrast to the political gains to be made by being a globalisation-sceptic. As a result, the political capital needed to push ahead with any further liberalisation measures is now limited, at best. On the other hand, there appear to be rising political payoffs from advocating policies designed to mitigate or avoid the perceived negative side-effects of today's global economy.

This development is particularly visible in the United States, although it is also quite apparent in Western Europe (witness for example the debate in France about *délocalisation* in the lead-up to the *non* vote in the 2005 referendum on the EU's constitutional treaty, or the reaction of the French and Luxembourg governments to Mittal Steel's successful bid for Arcelor). The possibility that the country which has done the most to promote the current global economy may rethink its stance towards globalisation would represent a big change in the international economic environment. Such a shift would be particularly striking as the United States has been a big winner from globalisation: on one count, estimated annual gains due to the combined effects of policy liberalisation and technological progress are large and positive, in the order of US$1 trillion (in 2003 dollars). The same source puts the estimated gain in the range of US$2,800 to US$5,000 additional income for the average person and between US$7,100 and US$12,900 for the average household.[6] So if globalisation has provided a significant boost to US (and European) incomes, from where is the impetus for a policy shift coming? Much of it relates to adjustment pressures created by the globalisation-powered rise of China and India, which are confronting developed economy politicians and populations with a series of challenges. Some are scared by the success of globalisation in creating powerful new competitors in global markets and spooked by the security implications of the resultant shifts in economic power. Others are ill at ease with a rise in national inequality that seems to be a side-effect of globalisation, and troubled by the implications of expanding trade with low-wage developing economies. Finally, some are rattled by the resource security implications of big new commodity consumers, and exercised by the environmental consequences of the rapid industrialisation and urbanisation of the world's two most populous economies.[7]

Scared by success

In the end, much of the current re-evaluation of globalisation is being spurred not by its failures but by its successes, in particular the economic emergence of China and (to a lesser extent at present) India.[8] Fears about globalisation are often synonymous with concerns about the consequences of the economic expansion of these two Asian giants, despite the fact that most of the world's trade and particularly investment flows still take place between the developed countries themselves.

There is a significant degree of irony here. Policymakers in the developed world have spent years preaching to their developing country counterparts that the path to greater prosperity lay in closer integration with world markets. Those counterparts in Beijing and, more recently, New Delhi, have listened, and the good news is that this particular piece of policy advice turned out to be bang on target.[9] Last year, for example, China's economy grew by more than 10½ % in real terms, its

fastest pace in more than a decade, while India's growth rate of around 9 % was that country's best performance for more than 15 years. Global growth and inflation have also benefited from the experience of these key developing economy 'globalisers', which between them account for more than one in three of the world's population.

But the prospect of intensifying economic competition from huge, dynamic new challengers, and the consequent adjustment strains in national economies, along with their inevitable political fallout, is triggering developed world angst. It has turned out to be a disconcerting experience for some in the latter to learn that foreign direct investment can flow in two directions, for example, such that firms in emerging markets can be the instigators as well as the targets of international acquisitions. For strategic traders, geo-economists and other modern quasi-mercantilists, an unqualified support for globalisation and open markets on the part of the developed world seems to be viewed in the same way as capitalists selling the rope to hang themselves.[10]

Rich world globalisation angst: made in the USA?

Discontent with globalisation is apparent in much of the developed world, although different regions or countries appear to focus on different issues. In Europe, for example, environmental strains seem to have a particular resonance, as does immigration. In the case of the United States, there seems to be relatively more concern about the impact of globalisation on labour markets and on inequality. Guillermo de la Dehesa suggests two reasons that participants in North American labour markets may be more likely to protest globalisation than their European counterparts.*

First, US labour markets are more 'flexible' than European ones. As a result, the adjustment to intensifying globalisation and the associated technological revolution has been sharper and quicker. European labour markets have higher firing costs and more generous minimum wages and unemployment protection. Under the European model, most adjustment is done not by labour market 'insiders', but rather 'outsiders'.

Second, much international trade in the EU is *intra*-industry trade (that is, trade between the same sectors) that arises as a result of factors such as product differentiation, branding, and economies of scale and scope. In contrast, a relatively higher share of US trade is *inter*-industry trade (between different sectors) reflecting the fact that the United States is a larger country than individual European nations, and a more diversified producer. Competition under inter-industry trade tends to be based more on costs, prices and wage levels, and therefore has a bigger effect on relative wages and prices.

A third possibility is that immigration into the United States has had a greater impact on relative wages than has migration into the EU.

* See Guillermo de la Dehesa, *Winners and losers in globalization*. Oxford, Blackwell, 2006.

While it is the economic transformation of the world's two billion-people-plus economies that represents globalisation's biggest achievement, and which lies at the heart of many of the anxieties the developed world currently feels about the process, apprehensions caused by globalisation's successes are not just about China and India. There are other by-products of the globalisation success story that also give cause for concern.

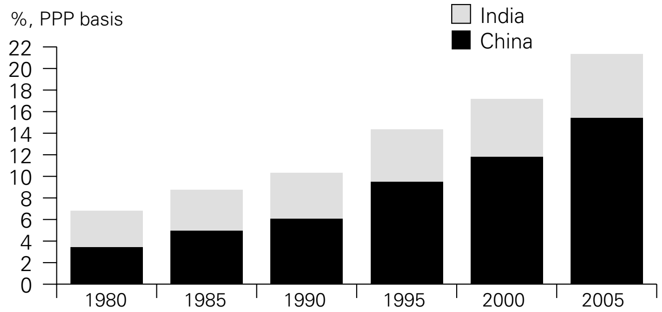
For example, one of the most frequently discussed in recent years is the case of global economic imbalances. The persistence of unusually large current account deficits and surpluses across the world economy, and in particular the huge US external shortfall, is often seen as one of the key policy challenges facing an otherwise rosy economic outlook: successive editions of the IMF's flagship *World Economic Outlook*, for example, have cited a disorderly unwinding of global imbalances as an important downside risk for the global economy.[11] Both the size and the duration of these imbalances is in many ways a consequence of globalisation, since it is the increasingly integrated nature of global

capital markets, and hence the greater ease with which capital can flow across borders, that have made it easier for countries to run larger external deficits for longer. This has had many benefits, but the scale of the resultant imbalances is also providing at least some observers of the global economy with more reasons to worry.[12]

Spooked by security

Reinforcing these various forms of economic angst is the anxiety created by the assumption that the shifts in the international distribution of economic weight currently underway will have geo-strategic consequences (Figure 2). Not surprisingly, such concerns are particularly important for the world's only superpower.

Figure 2
Share of world output



Source: IMF World Economic Outlook database September 2006

Optimists, including many (perhaps most?) economists, tend to think that China's integration into the world economy should, by promoting greater interdependence and by getting China's buy-in to the prevailing international order, reduce the risk of future conflict and so improve the security situation. Some would go even further, and suggest that economic development will see China converge towards Western-style political models.[13] But many security specialists view the consequences of the current round of globalisation-powered economic take-offs from a very different perspective. To quote Samuel Huntington, they believe that economists 'are blind to the fact that economic activity is a source of power as well as well-being. It is, indeed, probably the most important source of power, and . . . will be increasingly important in determining the primacy or subordination of states'.[14] Huntington was writing in the early 1990s about the perceived threat to US (economic) primacy posed by Japan, but analysts are now raising similar questions about China. John Mearsheimer, for example, has warned that if China continues its current economic progress over coming decades, then Washington and Beijing are likely to engage in 'dangerous' security competition.[15] From this perspective, it follows that current policies seeking to integrate China into the world economy and encourage its rapid economic take-off are misguided; rather, Washington has an interest in a *less* economically successful China, since this will produce a less formidable future competitor. Others argue that the United States should seek to actively limit the degree of its economic dependence on China on national security grounds.[16]

India's rise, too, is increasingly viewed in terms of its impact on the future balance of power, although at present more as a potential counterweight to China than as a future rival to the United States.

To date, the influence of such views on the implementation of US international economic policy has been limited. Instead, policy has reflected the idea of former Deputy Secretary of State Robert Zoellick that Washington should encourage China to be a 'responsible stakeholder' in the global economy. Nevertheless, they remain an important part of the atmospherics. Harvard's Jeffry Frieden has pointed out that in the aftermath of the Second World War both the general public in the United States and the political class were reconciled to a liberal trade regime as part of a Grand Strategy to defeat communism. Then, giving an economic leg-up to allies in Western Europe and Japan by providing easier access to the vast US market was seen as compatible with national security concerns. In contrast, since the end of the Cold War, the connection between national security and international economic engagement is often either no longer viewed as clear-cut (in the case of

international terrorism) or even as pushing in the opposite direction (in the case of the rise of China).[17]

Today, then, the security feedback effect is tending to run in the opposite direction from during the Cold War, with security concerns often working to produce *less* tolerance for, or more suspicion towards, international economic engagement. Evidence of this was seen in the very negative reaction to the 2005 bid by the 70 % state-owned China National Overseas Oil Company (CNOOC) for US oil company Unocal, and the 2006 furore arising from the UAE-based Dubai Ports World's purchase of P&O and consequent assumption of management contracts with six US ports.

Ill at ease with inequality

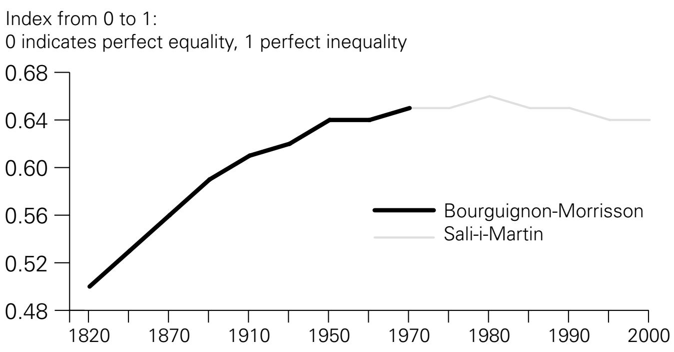
While concerns about economic and national security are becoming important influences on the general appetite for more globalisation, for now the more pressing force acting to change the current pro-globalisation policy settings is a growing concern that they are fostering rising inequality.

First, however, note that *even if* inequality is on the rise, this is not necessarily a straightforward indictment of participation in globalisation, since it may well be explained by a growing gap between participants and non-participants. This could be the case both at the international level (with a gap between globalising economies and non-globalising economies) and at the national level (for example with a gap between regions that have integrated with the global economy and those that have failed to do so).[18] The policy prescription then would be to increase the number of participants in globalisation, *not* wind back the process itself.

In fact, globalisation has probably been associated with a *fall* in overall global income inequality, in large part because of the economic success of China, and more recently India, in closing some of the gap between their level of income per capita and that prevailing in the rich countries. One simple measure of inequality, the global Gini index, has, for example, declined in recent years after increasing since at least the early nineteenth century (see box and Figure 3). At the same time, however, globalisation has also been correlated with a rise in inequality *within* many (but not all) participating economies.

This latter trend is visible in some major emerging markets, including China, where the growth-led closing of the income gap with the developed world has occurred at the same time as a dramatic rise in national inequality. Indeed, to some extent, an increase in inequality during economic development is an expected part of the process — hence the Kuznets hypothesis, which posits an inverse U-shaped relationship between the level of income per capita and income inequality.[19] Even so, rapid increases in inequality can create serious headaches for policymakers, raising concerns about social stability (for example China) and electoral outcomes (for example India) that have important consequences for policy choices over the pace and direction of liberalisation.

Figure 3
Global Gini index



Sources: Bourguignon and Morrison (2002) and Sali-i-Martin (2006)

In terms of the implications for the overall global policy environment, however, it is the globalisation and inequality debate in the advanced economies that is more important. Here, the argument that is increasingly heard is that globalisation has tilted the playing field against labour and towards capital, while at the same time boosting

the rewards to a small group of 'superstars'.[20] The apparent correlation between globalisation and inequality is now receiving a lot of attention. For example, *The Economist* magazine, typically a strong globalisation advocate, warned recently that a 'poisonous mix of inequality and sluggish wages threatens globalisation'.[21] Similarly, Larry Summers, former US Treasury Secretary during the Clinton administration, has used his column in the *Financial Times* to draw attention to the spread of anti-globalisation sentiment, which he locates in a 'growing recognition that the vast global middle is not sharing the benefits of the current period of economic growth — and that its share of the pie may even be shrinking'.[22]

Does globalisation increase or reduce inequality?

There is a long-running debate over whether globalisation has produced greater *international* polarisation of incomes. It turns out that the answer depends on the precise definition of world inequality. The World Bank's Branko Milanovic makes a useful distinction between three different concepts.[*]

Concept 1 inequality, or unweighted international inequality, compares inequality across countries by looking at differences in average GDP per head. But by focusing only on countries, it effectively treats developments in say China, with 1.3 billion people, as having the same impact on inequality as developments in say East Timor (which has a population of less than 1 million). **Concept 2 inequality**, or population-weighted inequality, corrects for this failing by weighting GDP per head comparisons by the relative population of each country. The shortcoming of this measure is that it assumes all Chinese (or all Timorese) have the same average income, taking no account of income inequality within countries. **Concept 3 inequality**, or the world income distribution, looks at inequality across individuals, taking into account not only the population-weighted distribution of incomes across countries, but also the distribution of incomes within countries.

The evidence shows that Concept 1 inequality has been rising almost continually since the nineteenth century, driven by the uneven spread of economic progress across countries. Globalisation has not reversed this trend. Concept 2 inequality has also increased for most of this period, but, following the integration of the two billion-people-plus economies of China and India into the world economy, has more recently started to decline.[**] In this sense, globalisation has been correlated with a reduction in inequality. What of Concept 3 inequality? Here, two offsetting factors have been at work. On the one hand, the improved economic performance of China and India that has worked to reduce Concept 2 inequality has also helped lower Concept 3 inequality. But this positive effect has been offset by a rise in inequality *within* some of the major developed and developing economies. While the net effect of these two offsetting developments is still the subject of heated debate, on balance it appears that the former effect has dominated in the globalisation period.[***]

[*] See Chapter 1 in Branko Milanovic, *Worlds apart: measuring international and global inequality*. Princeton and Oxford, Princeton University Press, 2005.

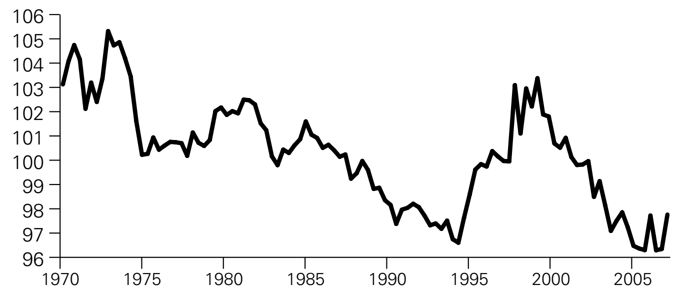
[**] Milanovic, W*orlds apart*, pp 140-142.

[***] For an optimistic reading see for example Xavier Sala-i-Martin, The world distribution of income: falling poverty and…convergence, period. *Quarterly Journal of Economics,* Vol. CXXI No. 2, 2006. Milanovic's assessment is much more cautious. See chapter 9 in Milanovic, *Worlds apart*.

Perhaps the simplest version of this story runs as follows: the economic integration into the world economy of populous developing economies like China and India represents a dramatic increase in the effective global labour force. Since these economies are also relatively capital poor, one consequence of globalisation is a big fall in the global ratio of capital to labour. All else being equal, that in turn implies a fall in

returns to labour and a rise in returns to capital.[23] Of course, this story abstracts from a whole series of complicating and potentially offsetting factors, including demographic change. Nevertheless, it is supported by some real world evidence: the share of national income going to labour in the developed world has been declining in recent years, and has now fallen to record lows. Conversely, the share of national income going to capital is at historic highs.[24]

Figure 4
Labour share of US national income
Index, 1992=100, nonfarm business sector

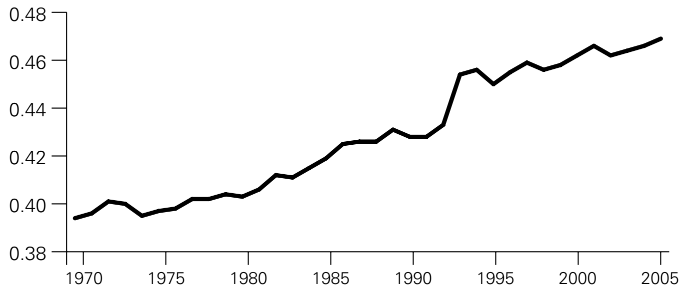


Source: US Bureau of Labor Statistics

While labour's declining share of national income is visible across developed economies, the inequality debate currently has a particular resonance in the United States. Leading commentators like Paul Krugman have been pointing to the contrast between stagnant (real) wage growth for many workers against booming corporate profitability and soaring incomes at the very top end of the US income distribution. Krugman, for example, cites data showing that while the hourly wage of the average American non-supervisory worker, adjusted for inflation, is lower than it was in 1970, at the same time CEO pay has increased from less than 30 times the average wage to almost 300 times the typical worker's pay.[25] The data do suggest that the benefits from strong US productivity growth appear to have been distributed unevenly: on one count, since 1997 only the top 10 % of the US income distribution have experienced growth in their labour income equal to or above aggregate productivity growth.[26] Some labour economists have described a polarisation of the US labour market, into high-wage and low-wage job segments.[27]

The US Gini index has been increasing steadily in the United States since the 1980s, indicating growing inequality (Figure 5). The reading for 2005 was the highest ever recorded.[28]

Figure 5
US Gini Index
Index from 0 to 1:
0 indicates perfect equality, 1 perfect inequality



Source: US Census Bureau

Interestingly, there is a difference in the nature of the growth in inequality since the 1980s. Up until around the end of that decade, inequality seems to have increased across the whole of the income distribution, with the gap between the bottom and middle of the distribution growing at the same time as the gap between the middle and the top. In contrast, since the 1990s the gap between the bottom and the middle has stopped growing, with the main driver of inequality being the expansion in the gap between the top of the income distribution and everyone else (the superstar phenomenon).

Economists continue to argue over whether globalisation is the main driver of greater inequality or whether other factors such as technology or demography are more important, and even to what extent the

observed increase in inequality is something to be worried about.[29] Still, there is little doubt that in terms of both the political debate and the popular discussion that fuels it, globalisation receives a large share of the blame. Certainly, it was against this backdrop that the Democrats captured both the House and Senate in the 2006 elections. While that result reflected a whole series of issues, many of them clearly non-economic, some observers have argued that the result nevertheless signals a shift in the balance of political power in the United States back towards labour and away from capital, triggered in part as a response to the income shifts outlined above.[30]

Troubled by trade

General scepticism about the (distribution of the) benefits of globalisation in the developed world has inevitably been matched by renewed doubts about the specific case for free trade. As a consequence of the trends in inequality discussed above, there has been a renewed focus on the possibility that increased trade with low-income countries will have negative results for (particularly low-skilled) workers in the developed world.[31]

This is not a new worry.[32] During the 1980s and early 1990s nearly all rich economies experienced a worsening in the position of the less skilled part of the workforce, reflected either in declining relative wages (in the United States) or an increased risk of unemployment (in Western Europe). Given that this occurred at the same time as imports from developing countries were on the rise, there was an empirical debate in the early 1990s as to whether this correlation also implied causation. Technological change was again advanced as the most likely alternative explanatory factor. Then, there seems to have been something approaching a consensus to the effect that while trade with developing economies did have an adverse impact on less skilled workers in the developed world, technology was probably more important.[33] On one assessment, for example, globalisation was found to explain around 20 % of the observed increase in wage inequality, with the IT revolution responsible for around 60 %.[34] In practice, however, the distinction between the two hypotheses may not be clear-cut: for example the prospect of foreign competition may have spurred firms in newly contestable industries to invest in labour-saving technological change.

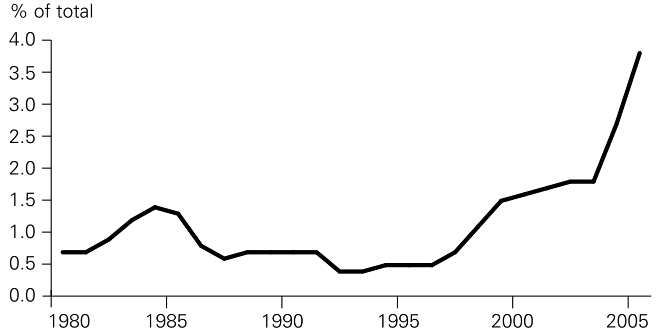
This debate has now been given new life following the emergence of China in particular as a major new low-cost exporter of manufactured products, and the associated growth in the share of low-income economies in developed country trade.[35]

At the same time, and alongside these longer-standing concerns about the implications for income distribution of international trade, there have been more recent fears that a series of changes to the international environment has somehow altered the cost-benefit equation for trade openness for the developed economies. For example, some commentators have argued that the combined effects of the rise in global capital flows, the information technology revolution, the economic integration of China and India, and the increased use of international outsourcing have together produced a 'new global era' in which the old case for free trade may no longer apply.[36] One particular concern here seems to be that economies like China and India will be able to advance quickly up the value chain and compete in markets hitherto the preserve of the developed economies. In this context, some economists have pointed to the possibility that catch-up by developing countries could indeed, via the impact of adverse movements in the terms of trade, impose income losses on advanced economies.[37] To some degree these sorts of fears also play into the national security concerns about the consequences of globalisation in the form of worries about the loss of strategic industries.[38]

The rise of the international outsourcing, or offshoring, of service sector jobs has been at the heart of arguments about the changing nature of the trading environment. Beginning with the offshoring of relatively low-skilled jobs such as call centre positions in the early 1990s, international outsourcing of white collar jobs has progressed to more skilled roles in IT and financial services. The rapid growth in market share in services trade by India (Figure 6) and the apparent potential for large-scale losses of knowledge-intensive jobs prompted some to

argue that trade in services was different to trade in goods and therefore required a different policy response.[39] These concerns were the subject of intense discussion in the United States in the run-up to the 2004 presidential elections, although much of the heat went out of the debate once the election was over, in part because most estimates seemed to suggest that in fact the total number of jobs affected was actually quite small relative to the overall size of the US labour market. However, several economists have pointed out that while the *current* impact of service sector offshoring may still be quite limited, the potential effects could yet turn out to be very large indeed.[40] Moreover, the effective expansion of the traded sector of the economy means that there has already been an important psychological effect, in that a new set of workers now feels exposed to the winds of international competition, and hence more ambivalent about open markets.

Figure 6
India s share of world other commercial services exports



Source: WTO International trade statistics

Finally, in the United States, trade concerns have also been wrapped up in two other policy issues: the country's large external trade and current account deficits, and the relationship between Washington and Beijing. More specifically, while much of the economic debate over the US external shortfall has tended to be couched in the relatively neutral terms of savings and investment balances, politicians have zeroed in on trade policy in general, and on the large bilateral deficit that the

United States is now running with China in particular, as the source of the problem. Last year, when China overtook Mexico as the United States' second largest trading partner, the red ink hit a new record as the bilateral merchandise trade gap blew out to a record US$232.5 billion, or more than 28 % of the total US trade deficit in goods.[41] Many US politicians promptly became even unhappier with Beijing.

The ballooning bilateral trade deficit has now become a powerful symbol of several mutually reinforcing concerns in Washington: the economic and security challenge posed by the rise of China; the economic risks associated with large external deficits; and the worries about jobs and inequality arising from growing competition from low-income economies. Together, they make for a potent combination.

Rattled by resource security . . .

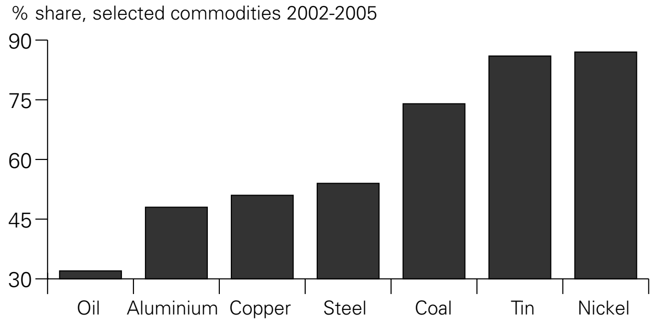
Another area where the consequences of globalisation in general, and the rise of new economic powers in particular, have triggered a mix of economic and national security concerns is resource security.[42] After all, the case of competition for the consumption of non-renewable resources seems to provide an obvious zero-sum counter-example to most economists' determinedly optimistic view of trade and globalisation as positive-sum games, and so provide a case for restricting or winding back the operation of the market. Thus during the furore over CNOOC's abortive bid for Unocal in 2005 mentioned above, many of the formal objections to the deal cited national and energy security concerns.[43]

Fears that the world might be running out of resources have been around since at least the time of Thomas Malthus's *Essay* on population.[44] The run-up in resource (particularly energy) prices during the 1970s prompted a more recent bout of worries about the impact of scarcity on economic growth, shortly followed by discussion about the case for energy security, as major developed economies became more reliant on imports to meet their consumption needs.[45] To date, technological progress, taking the form of innovations in production, extraction, conservation and substitution, has worked

to ensure that these earlier bouts of resource pessimism have turned out to be unfounded, at least insofar as a scarcity constraint to growth is concerned. But the prospect of a sustained boost to commodity demand, and hence commodity prices, due to the industrialisation and urbanisation of the two giant Asian economies is, once again, resurrecting old debates.

China in particular has emerged as one of the world's biggest commodity consumers. It is now the world's largest consumer of the major metals, the second largest user of energy, and the first or second largest consumer of many agricultural products. India currently ranks several places below China for metals and energy products, but is still an important player.[46] The growth in Chinese demand has been an important driver of commodity markets in recent years: between 2002 and 2005, China accounted for more than 30 % of the growth in global consumption of oil, more than 45 % of the growth in global consumption of copper and steel, and more than 70 % of the growth in global consumption of coal (Figure 7). The trend is set to continue: economic modelling by the Asian Development Bank suggests that between 2001 and 2015 developing Asia, led by China and India, will contribute over 60 % of the global increase in commodity demand.[47]

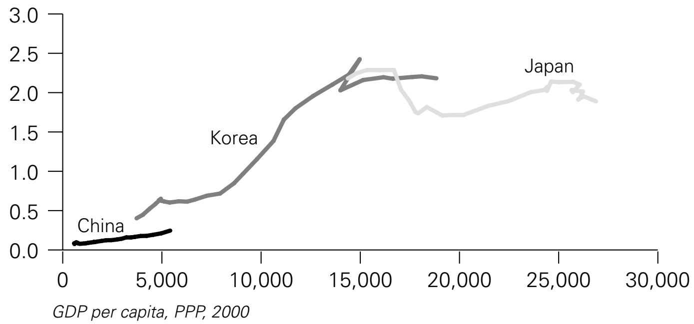
Figure 7
China s contribution to world consumption growth



Source: media reports, various

What is particularly striking is that China's impact on world commodity markets is taking place at what are still relatively low levels of per capita consumption. Consumption per capita of petroleum for example, is still a fraction of that in richer Asian economies (Figure 8). If China were to follow a similar growth-resource development path to previous industrialising economies, then the scale of the resultant demand shock to commodity markets would be truly dramatic. This is, of course, quite a big 'if', since it assumes no dramatic shifts in technology, tastes or relative prices.

Figure 8
Oil demand and economic development
Oil consumption, tonnes per capita, 1975-2004



Sources: World Bank World Development Indicators and BP Statistical Review of World Energy (2006)

For developed economy importers of commodities, the implications of Chinese and Indian demand are, all else equal, higher prices, bigger import bills and an adverse movement in their terms of trade (the ratio of their export to import prices), although the demand effect on commodity prices has to be offset against the positive impact of lower import prices for labour-intensive manufactures.[48] The impact is about more than price, however. The growth of new demand, along with the location of existing and likely future supply, means that the world economy is destined to become increasingly dependent on cross-border trade in resources. Ideally, effectively functioning international

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markets for resources would be central to meeting the resulting resource security concerns. After all, these are fungible commodities whose price is set on the global market. Unfortunately, many of the world's governments don't seem to buy this argument, particularly when it comes to energy. Indeed, energy markets are already subject to a particularly high degree of government intervention: for example, partially or wholly state-owned firms are thought to control as much as 90% of the world's oil and gas.[49] With resource nationalism on the rise, fuelled by higher prices, the prospect is for governments to become yet more involved. On the supply side, higher energy prices are prompting governments in some emerging markets to exert greater control over increasingly valuable national resources. And on the demand side, China and India are already busy searching the globe to 'secure' their access to future energy resources. The risk here is that any intensification of this scramble to lock up energy resources spills over into geo-strategic competition and undermines cross-border trade and investment flows.[50] Such policies could end up exacerbating the very risks they are intended to ameliorate.

. . . and exercised by the environment

It is not just the resource security implications of globalisation that are sounding warning bells over the consequences of fuelling the economic take-off of the Chinese and Indian economies. The environmental implications of globalisation are also receiving increased attention. One risk, for example, is that globalisation will lead to an increase in pollution, since by encouraging industry to move to developing countries, production will tend to be relocated to states with relatively lower environmental standards and less formal regulation than those prevailing in the developed world.

The pessimistic case is that globalisation will entail an environmental race to the bottom, encompassing both the developed and developing world, as global competition for investment undermines any ability either to introduce or to sustain regulation to improve the environment. Another depressing scenario is environmental polarisation, whereby there is a growing disparity in environmental conditions across countries, reflecting continued improvements in the developed world that are achieved in part by effectively offshoring environmental costs to developing countries.[51]

The evidence on the race to the bottom hypothesis to date is not especially convincing. Indeed, there is a more optimistic possibility, whereby, rather than a race to the bottom, globalisation could instead lead to a process of 'ecological modernisation' as countries become more environmentally aware in line with rising per capita incomes. As globalisation boosts wealth, this in turn might be expected to boost demands within developing countries for improvements in environmental quality, much as has happened in the developed world. This argument envisions an environmental version of the Kuznets curve with an inverse U-shaped relationship between environmental problems and income per capita, such that income gains beyond a certain point are associated with environmental gains rather than further degradation.[52]

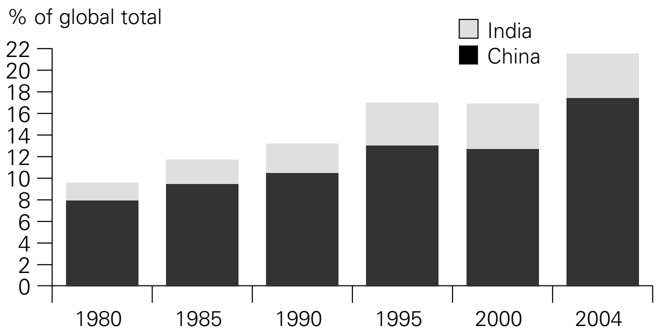
The optimistic scenario may well be right in the long run. China's official attitude to the environment has already undergone a dramatic change, for example, and the legal framework is reportedly now one of the best among developing countries, although compliance remains poor.[53] In the near term, however, the pressures are great, particularly since the new economic giants are probably still on the wrong side of the environmental Kuznets curve. According to one recent assessment, China's environmental problems, for example, are already 'among the most severe of any major country'. The same assessment goes on to point out that these environmental problems are also spilling over into other countries. China is the largest contributor of sulphur oxides (acid rain) and chlorofluorocarbons to the atmosphere, while aerial particles from China (dust, sand and soils) affect Korea, Japan, the Pacific Islands and even the United States.[54]

While emerging markets like China and India are struggling with a whole series of environmental problems including water scarcity, air pollution and soil erosion, for the public and politicians in the developed world, currently the most pressing international environmental issue

on the policy agenda is climate change. The reception given both to the release of the Stern Review on the economics of climate change last year, and then to the latest assessment report by the Intergovernmental Panel on Climate Change (IPCC), indicates a fundamental shift in attitudes towards climate change and a growing willingness to embrace a more aggressive policy response. Here again, Asia's two new economic powers pose some significant challenges, with the IPCC report itself highlighting the role of China and India as part of the global pollution problem.[55]

In fact, the overall level of carbon in the atmosphere is overwhelmingly a legacy of the *developed* world's industrialisation. Of the cumulative CO_2 emissions between 1850 and 2002, the United States accounts for about 29% and the EU-25 26%. China's share is less than 8% and India's around 2%.[56] But globalisation-enabled growth has pushed China and India up the league table of current and future emitters. Indeed, China is *already* the second largest emitter of greenhouse gases after the United States, despite having a still relatively low level of per capita emissions: its share of global greenhouse gas emissions in 2000 accounted for just under 15% of the total, compared to close to 21% for the United States. In the same year, India was in fifth spot, accounting for about 5.5% of the total.[57] Moreover, on most projections, the joint share of emissions is set to increase markedly over coming years, making both countries increasingly central to the climate change policy debate. The International Energy Agency (IEA), for example, reckons that by 2009 China will have passed the United States as the largest emitter of the types of greenhouse gas that are energy-related and forecasts from the Energy Information Administration (EIA) follow a similar trajectory. Projections by the World Bank show both China and India retaining a heavy reliance on fossil fuels for the next two decades, with CO_2 emissions for energy use set to more than double for China by 2020 and almost double for India over the same period.[58]

Figure 9
Share of World CO2 emissions



Data from EIA International Energ Annual 2004.
Projections from EIA Annual Energ Outlook 2006, Reference y ase

Source: Energy Information Administration International Energy Outlook

Both China and India have ratified the Kyoto Protocol, but as developing countries they have assumed no responsibility for reducing carbon emissions other than those arising from mechanisms such as the Clean Development Mechanism (CDM).[59] While some observers think that the incentives provided through the CDM are a good way to tackle the emissions challenges posed by China and India, it is far from clear that on their own they will be enough to generate significant reductions in emissions.[60]

Chapter 3

Institutional failure

In *The Lexus and the Olive Tree,* Thomas Friedman suggests that the 'most basic truth about globalisation is this: no one is in charge' with the result that there is nobody to call when something goes wrong.[61] Yet, in theory at least, there *are* people (or institutions) to call when things get sticky. Worried about the overall direction of the global economy or misalignments between major exchange rates? Maybe the G7 can help. A severe financial crisis? Then call in the IMF. Difficulties with international trade protectionism? Go to the WTO. The problem, however, is that all of these institutions seem to be finding it increasingly difficult to fulfil their mandates. In other words, while there is someone to call, those on the other end of the line are increasingly ill-equipped to provide any meaningful help. Again, there is a significant degree of irony here. Greater international economic integration means that there are significantly increased payoffs to be had from enhanced international cooperation. Yet the consequences of globalisation are helping to undermine the very international institutions that are supposed to facilitate that cooperation.[62] The failure of the international economic architecture to cope with the challenges posed by the new global economy is another contributory factor to the present uncertainty about globalisation.

Take the G7 and the IMF, the two international institutions at the top of the heap when it comes to trying to guide the broad direction of the world economy.[63] Roughly speaking, the G7 has the greater leadership or strategic role, while the Fund is the key implementing institution. The latter is also the institution tasked with dealing with financial crises. For both bodies, globalisation, and in particular the resultant shift in the distribution of economic power towards China and India and other major emerging markets, has challenged their relevance and their legitimacy.

This is particularly obvious in the case of the G7, which is arguably the closest we have yet come to an informal steering committee for the world economy. The G7's ability to tackle current international policy challenges is increasingly limited by its narrow membership. So while a series of G7 communiqués has commented on issues ranging from global imbalances through the future of world trade negotiations to energy security, the fact that its membership excludes the rising new powers of the world economy, except on an *ad hoc* basis, turns much of this commentary into empty rhetoric. One response to this clear failing has been calls for the G7's role to be replaced by the much more representative G-20.[64]

In theory, the much broader membership of the IMF should leave it better placed than the G7 to cope with the changing geography of the global economy. But the Fund has problems of its own. For a start, it too has a legitimacy problem: in terms of the distribution of voting power within the IMF, for example, it has long been recognised that several major emerging markets have been under-represented relative to their growing weight in the world economy.[65] Moreover, the Fund is also struggling to define its role in the new economic circumstances that now prevail. Originally created to manage a now long defunct system of pegged but adjustable exchange rates, the IMF has had to reinvent itself several times in its history. In its latest incarnation one of its main tasks has been to help coordinate (not always successfully) the response to major emerging market financial crises and it has also established itself as the leading voice in international economic policy matters. Today, neither role is a particularly comfortable fit. In recent years emerging markets, particularly in Asia, have been busily self-insuring

by accumulating large stocks of foreign exchange reserves in order to avoid having to subject themselves to the unpleasantness of a Fund program, and several large borrowers have repaid the Fund early so that they too no longer have to heed its strictures. This leaves this part of the IMF's role looking rather threadbare: a recent article in *The Economist* magazine, noting how an IMF loan to Turkey now accounts for much of the Fund's outstanding credit, suggested that the IMF had in effect become the TMF, or Turkish Monetary Fund.[66] The IMF's role as a purveyor of policy advice has also been compromised: rich countries have always preferred to take their own counsel in terms of national economic policy, and as they gain in confidence and wealth, the major emerging markets are increasingly following suit. One example of the institution's relative impotence here is the case of global economic imbalances, where despite repeated warnings about the risks involved, the influence on individual country policy has been negligible.

The good news is that the IMF is making efforts to deal with these shortcomings, with a reform process based around its Medium-Term Strategy (MTS).[67] In terms of the IMF's surveillance mandate, for example, in April 2006, the Fund announced the Multilateral Consultations initiative, which aims at bringing together systemically important countries to collectively focus on major issues. The first consultation process is focussed on global imbalances with the United States, China, the Euro area, Japan, and Saudi Arabia as participants. But with the first anniversary approaching, it is difficult to point to much progress. Things look better on the representation front. In September 2006, the IMF Board of Governors agreed on immediate quota increases to the four members most clearly under-represented under the current quota system: China, Korea, Mexico and Turkey. As well as this initial down payment on reform, they also agreed on the need for a new quota formula that would do a better job of capturing changes in the world economy, and on the need for future quota increases based on that new formula once it had been agreed. A report on the revised quota formula is scheduled for the 2007 spring meetings with agreement targeted if possible by the 2007 annual meetings, and at the latest by 2008 annual meetings. Since the reform process will imply losers (in terms of reduced representation) as well as winners, negotiations over the new approach are expected to be hard going.

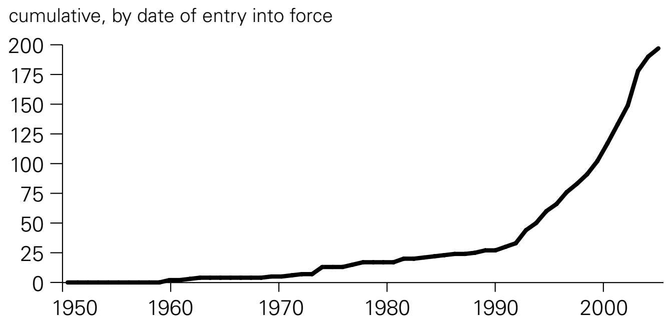
In the case of the WTO, the organisation is similarly struggling to deal with the new international economic order.[68] In part, this is again a problem of success. Just as trade has grown in importance to the world economy, so has WTO (formerly GATT) membership: from the original 23 signatories to the GATT in 1947, the number of members has expanded to 150. This means that WTO negotiations now include countries who between them account for more than 95 % of total world trade. Country membership is also much more diverse. The original GATT was basically a rich countries club, whereas today the large emerging markets have an increasingly central part to play in WTO negotiations. Those negotiations also encompass a much broader array of issues than before, including intellectual property rights and services as well as goods trade. More members, a more diverse membership, more trade and more issues all mean that trade negotiations are now tougher and take longer.

One indicator of this is that there has now been only one successful trade round in the past quarter-century and counting. Meanwhile, progress with the current Doha round has been glacial, with negotiations temporarily suspended in July 2006 and only restarted in February 2007. It's true that, aside from the negotiations, other parts of the multilateral trading system continue to function quite well. There is general agreement that a combination of existing trade agreements and the dispute settlements mechanism have done a good job in helping to prevent protectionist rhetoric turning into reality, for example.[69] But this might not be enough. As a 2005 report to the WTO director-general pointed out, at heart the WTO is a negotiating machine. To the extent that it becomes unable to negotiate effectively, its position becomes precarious.[70]

A sign of eroding confidence in the WTO and the multilateral system it supports is the rapid expansion of various forms of preferential trade agreements (PTAs) as governments seek to supplement the grindingly slow multilateral system with bilateral and regional deals (Figure 10). Today, there are roughly 200 such agreements in operation, and the WTO reckons that by 2010 that number could have doubled to 400. Individual trade agreements have their pros and cons, but the prospect

of a world economy covered by a web of inconsistent trade deals raises the risk that policy will end up impeding rather than encouraging cross-border trade, due for example to different rules of origin. This danger, combined with the problems of the current multilateral trade round, has sparked the search for a new 'Plan B' for world trade.[71]

Figure 10
PTAs notified to GATT/WTO



Source: WTO web site

This potential threat of a splintering of the global trading system into a series of small regional or other sub-groupings is part of a broader trend, as disenchantment with the array of global institutions on offer has prompted a degree of substitution towards regional alternatives. In other words, while markets have gone global, policy has gone regional. The Europeans are the most advanced at this game, with the Euro-area and EU, along with the network of European Association Agreements outside them, providing an expanding zone of European-compatible policies and institutions. On a more modest scale, the United States has turned to bilateral trade agreements to advance its agenda in areas such as intellectual property rights. In East Asia the regional architecture remains relatively rudimentary, certainly by European standards, but the direction of change is clear, with the emergence of ASEAN + 3 and the East Asian Summit (EAS) as competing visions for advancing regional integration.

Chapter 4

Can national institutions cope?

Not all of the challenges posed by globalisation are amenable to treatment at the international — global or regional — level. In particular, it is the role of domestic institutions to provide their nationals with a degree of protection against the pressures emerging from the global economy. One interpretation of the post World War II international economic order, for example, sees the successful move towards international trade liberalisation as resting on the presence of a domestic social bargain, whereby as trade barriers declined, governments became progressively more active in managing the domestic consequences.[72] Several commentators have worried that globalisation may be reducing the ability of governments to continue to live up to that bargain, in particular by creating 'hard times' for welfare states.[73]

As in the environmental debate, the fear is that globalisation will trigger a race to the bottom. In particular, that international economic integration plus technological progress will equal a declining ability to collect taxes. Vito Tanzi, for example, has identified 'fiscal termites' in the evolving ecosystem of globalisation which are gnawing away at the foundations of national tax systems. These fiscal termites include an inability (or unwillingness) to tax mobile financial capital and the incomes of those with highly tradable skills, as well as the growth of offshore financial centres and trade within multinational corporations, along with innovations such as e-commerce and e-money.[74] Drained of revenue support, it will become harder for governments to support welfare states, and hence to secure the public support necessary to maintain open markets. A broader version of this argument holds that while the Cold War era was a period of 'systems competition' between communism and capitalism, the new version of competition is one for locational advantage driven by international movements of goods, capital and people. This international mobility places competitive pressures on economies such that national policies have to take into account any implications for cross-border activities — a constraint which would apply to a whole range of domestic policy issues beyond taxes, including social spending, public goods, laws and regulatory systems.[75] Similarly, Dani Rodrik has argued that a move towards 'true' international economic integration requires the sacrifice of either the nation state (in favour of some kind of global federalism) or mass politics (in the sense that large realms of economic life would be taken out of the political domain and geared instead toward compatibility with global markets).[76]

As is the case with the environmental race to the bottom, however, strong evidence for these sorts of propositions has so far proved to be hard to come by. For example, OECD data on welfare spending (which includes expenditure on health, social services, and social security, but not education) between 1980 and 2001 actually show a *rise* in the average share of such spending in GDP.[77] Similarly, there is also little sign of any convergence in welfare spending across OECD economies, with distinctive social models (Scandinavian versus US, for example) persisting in the face of globalisation. True, there *is* evidence that there has been both a significant fall in corporate tax rates across OECD economies and a convergence in those rates, and there has also been something of a general tendency to reduce income tax rates for high earners. In both cases, the international mobility of the tax payer has been cited as an explanatory factor. It turns out, however, that most tax revenues come from sources that are not particularly subject to significant international pressures: taxes on corporations, for example, typically represent only 10-15 % of total revenue collections in the

OECD, and income taxes on high earners are a relatively small share. What's more, OECD corporate tax systems have been raising revenues for governments at roughly the same clip as they have done for the past 30 years.[78]

For now, then, fears that globalisation will undermine the ability of national governments to provide shock absorbers for their populations seem unfounded: the current bout of globalisation angst can't easily be traced to any major adverse consequences for developed economy welfare states.

Chapter 5

Tracking the policy response

In summary, globalisation in general and the rise of China and India in particular are presenting the developed world with a series of reasons to worry. Meanwhile, international institutions appear to be struggling with the changes in the global economy they are intended to oversee. On the other hand, national governments continue to retain a fair degree of autonomy in designing and funding domestic institutions that can offer their nationals some shelter from the world economy. Governments can still act, if they choose to do so.

Taken on its own, no single issue described above represents an insurmountable challenge to the case for a globalised economy. Indeed, in almost every case it is far from obvious that the best policy response would be to abandon, or even seek to slow down, international economic integration. Nevertheless, the cumulative effect of all these fears is exerting pressure on policymakers and politicians in the developed world, particularly in the United States, and with globalisation seen as the connecting factor some form of policy response is likely. At the very least, the previous bias towards pro-globalisation policies will increasingly be challenged — something indeed which is already happening. The ultimate policy reaction could well go further than this, however, and actively seek to either modify or constrain some aspects of globalisation.

How likely is such a policy rethink? The concerns listed above suggest four key areas to monitor for evidence of any swing in policy direction.

'*Déjà vu* all over again?'

To some extent, the tensions between the United States and China are reminiscent of the strains in the US-Japan relationship in the late 1980s and early 1990s.* In particular, there are some clear parallels between the current period and 1988, when a Republican President needed a Democrat-controlled Congress to renew fast-track authority to complete the Uruguay trade round at a time when US politicians were worried by import competition from Japan in the motor, steel and semiconductor industries.** The United States had already resorted to so-called Voluntary Export Restraints (VERs) in the early 1980s, and subsequently Congress came up with Super301, whereby the administration was required to threaten unilateral trade sanctions to force countries to open their markets to US goods. Yet despite all of the protectionist pressures of the time, fast-track was renewed, the Uruguay Round reached a successful conclusion, and there was no significant disruption to international trade flows.***

Is there any reason to think that Sino-US tensions will turn out any worse for the international economy than the US-Japan trade spats? Certainly that experience reminds us of the possibility of a significant gap between rhetoric and outcome. Still, there are also some interesting differences between the two episodes.**** In particular, inequality in the United States has increased relative to the 1980s, and the implicit pressures on US workers arising from a low wage economy like China are seen as greater than those coming from a wealthy Japan. Moreover, the divide in interests between capital and labour is much more apparent in the current episode; in the 1980s, both managers and workers were worried about losing out to Japanese competition. Today the adjustment burden has been shifted more heavily onto labour. The consequences of this latter trend for a protectionist backlash are mixed. On the one hand, it means that capital is more likely to be in favour of continued open markets. On the other, it increases the disenchantment of labour.

A further important difference between the two cases is that China's economic take-off has been far more dependent on FDI than Japan's, including FDI from the United States. The fact that many US corporations now have a significant stake in the Chinese economy means that there are powerful voices in Washington that will seek to act as a brake on any sharp drive towards protectionist policies.

* See for example Mark Thirlwell, *Revaluing the renminbi: a case of 'déjà vu all over again?* Lowy Institute Issues Brief. Sydney, Lowy Institute for International Policy, 2003.
** Edward Alden, Bush is right to push for renewal of his fast-track policy. *Financial Times*, 31 January 2007.
*** See Douglas A Irwin, *Free trade under fire*. Princeton, Princeton University Press, 2002, especially pp 179-180.
**** These points are raised by Stephen Roach, *Protectionist threats: then and now*. Morgan Stanley Research Global, 26 January 2007.

First, with international trade at the heart of the globalisation process, and with the WTO often seen as the would-be regulator of the new global economy (or alternatively as the 'Great Satan' of globalisation), one obvious starting point is the fate of the current round of world trade talks. Doha round negotiations were suspended in July 2006 due to irreconcilable differences over agricultural trade liberalisation at that stage, before being resumed in February this year. The challenge of getting a deal over the line remains substantial, and even if a deal can be forged, it may deliver little in terms of new market access. Crucially, however, there is a powerful asymmetry regarding the final outcome of the round; while the upside from successful negotiations would probably be quite modest, the downside of failure could turn out to be substantial. A failed round would be a defining moment for the global trading system, marking the first irrevocable breakdown in multilateral trade negotiations since the establishment of the GATT in 1948.[79] The future of the Doha round is therefore one important indicator of policymakers' appetite for continued globalisation.

A second and closely related indicator will be the response of the 110th US Congress to requests to renew the President's Trade Promotion Authority (TPA), previously known as fast track. Existing TPA is set to expire on 1 July this year, and in February President Bush asked Congress to extend his authority, something that will be needed if the Doha round is to reach a conclusion during the current administration.[80] Congressional renewal of TPA has become increasingly controversial and the last time authority was granted —in the form of the misleadingly titled Bipartisan Trade Promotion Authority Act of 2002 — it involved a hard fought, highly partisan battle in Congress, with the original House version passing by just one vote.[81] This time the fight to extend TPA could be even tougher given the shift in composition between the 109th and 110th Congress arising from the November 2006 elections.

As noted above, the outcome of those elections can be seen to some extent as a negative vote on the implications of globalisation. Certainly, many of the newly elected Democrats are fair rather than free traders, a development that one commentator has suggested heralds a 'revolution' in US trade policies. Another observer calculates that November's elections meant that at least seven Senate seats and thirty House seats that had been represented by supporters of liberal trade and investment policies were now in the hands of critics of such policies, with the new Congress 'likely to be the most populist in decades'.[82] Indeed, for the administration to have even a chance of securing an extension of TPA, it now appears that a compromise in terms of incorporating Democrat demands for tough requirements on labour standards will be required.[83]

The third issue worth close monitoring is US-China economic relations, where the political shift in the United States is once again a key factor. As noted earlier, the combination of concerns about rising inequality and its relationship to trade with low income economies, the

size of US external deficits, and the economic and strategic challenges posed by emerging powers have all come together in the form of the US-China bilateral trade deficit. In February 2007, Washington launched its largest complaint yet against China, citing alleged subsidies to Chinese manufacturing exports. Meanwhile, the ballooning trade deficit continues to be the subject of much political scrutiny: on one count, the last two years of the previous (109th) Congress produced 27 separate pieces of legislation targeting China.[84] Crucially, however, none of these was passed into law. Given the changes in composition in the 110th Congress, which have certainly *not* made it a more China-friendly place, more legislation is set to follow, with a range of proposals, including the Fair Currency Act of 2007 and the Nonmarket Economy Trade Remedy Act of 2007 having already been given an airing. More are in the offing.

The US administration has tried to head off such initiatives through the creation of a US-China strategic economic dialogue (SED), the inaugural round of which was held in Beijing in December 2006. Little was achieved at that meeting, however, and with the second round of the SED set to be held in Washington this May, this time there will be a significant degree of pressure to produce some concrete 'deliverables' to assuage the growing anti-China sentiment. In the absence of such progress, Congress is likely to act.

This means that Beijing's response to the growing threat of a protectionist backlash in the developed world is a fourth factor to monitor. Despite its dramatic successes, there are growing signs that China's investment- and export-driven development model is running into diminishing returns. In particular, the adverse trade policy reactions it is now triggering in the rest of the world mean it is threatening the consensus for global openness. China is not insensitive to this risk, and Beijing's ability to rebalance the Chinese economy towards a more domestic-focussed growth model will also be an important determinant of the rich world's policy stance.

These are probably the four main issues to track in monitoring any potential policy shift towards globalisation. But there are other possible pressure points. Resource and energy security issues comprise one area that may well see more action, particularly as the big developed-economy energy companies find themselves squeezed by their state-owned emerging market counterparts. The fate of the proposed governance reforms of the IMF will be another marker of the extent to which developed economies, particularly in Europe, which is expected to the biggest loser from any reallocation of voting rights, are willing to recognise the changing balance of economic power in the world economy.

Another interesting area to watch is that of environment-related issues. Recently there has been growing interest in efforts to 'green' international institutions in order to meet the international challenges posed by environmental problems. Joseph Stiglitz, for example, recently argued that the current international trade framework could be adapted to enforce environmental policies. In this case, his target was the United States and its refusal to sign the Kyoto Protocol.[85] Stiglitz's suggestion was that WTO regulations applying to domestic subsidies could be extended to the case of environmental damage, with refusal to sign Kyoto treated as equivalent to a hidden subsidy, and therefore open to countervailing action under the auspices of the WTO. Critics of the proposal have pointed out that the idea of a hidden subsidy could be used to target a whole range of issues, including labour standards in economies like China, and the EU trade commissioner has recently rejected French proposals along similar lines.[86]

Finally, note that a growing pressure for the extension of environmental and labour standards can be taken either as a sign of anti-globalisation or as a demand for more (but different) globalisation. The former might be the case to the extent that such calls are really a back door way to push traditional protectionist interests, for example. Alternatively, however, such demands could be interpreted as a desire to extend national policy concerns to the global level and, ultimately, as a demand for global standards.

Chapter 6

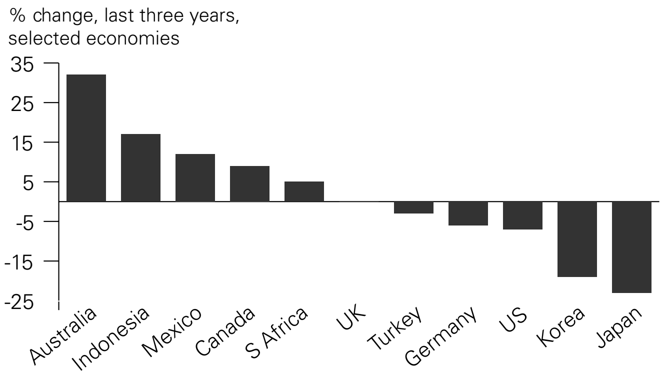
No worries for Australia?

Is growing developed economy angst about globalisation a policy issue for Australia? After all, in many ways Australia looks to be particularly well placed to benefit from globalisation in general, and from the rise of China and India in particular. As John Edwards emphasises in a recent Lowy Institute Paper, 'the contemporary configuration of the global economy is more congenial for Australia than it has been for over a hundred years. Australia is English speaking, at a time when … English has become the global language. It is a service economy, and has readily adopted suites of new technologies which are well suited to affluent service economies. It has been able to invest more or save less because it can freely draw on global savings. It has proved robust to competition. It has gained from falling manufactures prices, and rising commodity prices'.[87]

Certainly, the impact of recent developments has been to reshape Australia's external trade profile. By 2005-06, China had become Australia's second largest merchandise trading partner, its second largest export market, and its largest source of imports. India's influence remains more modest, but is far from insignificant: in the same year India was Australia's twelfth largest trading partner and seventh largest export market, but only 26th in the rank of importers. While some economies have found their terms of trade (the ratio of their export to import prices) squeezed by the rise of Asia's new giants, as a resource-rich commodity exporter and big importer of manufactured consumer products, Australia has instead enjoyed a big terms of trade boost from this new trade profile, one that has in turn provided a substantial lift to national prosperity (Figure 11).

Granted, there are some adjustment strains to be managed. It is possible that Australia's manufacturing exporters are now finding selling into global markets a tougher task.[88] There are also challenges involved in dealing with the shift in Australia's comparative advantage implied by the commodity price boom, and there may well be some important geopolitical complications down the track. But to date, the overall impact of the China boom in particular has clearly been strongly positive.[89] As a consequence, the angst about the rise of new powers displayed by the United States and Europe is not anywhere nearly as apparent in Australia. Australians are, however, concerned about the environmental consequences of a strongly growing global economy.[90]

Figure 11
Terms of trade shifts, winners and losers



Source: Adapted from table 4 in Edey (2007)

Australia also appears to have avoided some of the correlation between globalisation and inequality discussed above. There is little evidence

of any big increase in income inequality, for example: according to the Australian Bureau of Statistics, the Gini coefficient for disposable income was 0.294 in 2003/04, compared to 0.302 in 1994/95.[91] There have of course been losers as well as winners from the internationalisation of the Australian economy, and inequality of wealth may be a different story, but a highly redistributive welfare state appears to have done a good job in preventing any dramatic worsening in the income distribution.[92] Strong employment growth and a 16-year long economic boom have also played important roles here.

For Australia, then, most of the policy challenges look likely to be those that arise from other countries' insecurities about international economic integration. To take perhaps the crudest example, a significant shift to protectionist policies on the part of the United States and Europe targeted at China would change the international environment in ways that would be unfavourable to Australia, not least by potentially dampening the growth prospects of a key trading partner. Similarly, any decision by leading economic players in the developed world to retreat from the multilateral trading system would be bad news for a middle-sized power like Australia. Still, it seems likely that continued globalisation will confront Australians with some adjustment pains at home too, so it's possible that in the future Canberra too will have to deal with a local outbreak of globalisation angst.

Conclusion

After more than two decades during which policymakers in the developed world have largely pursued pro-globalisation policies, there is a growing possibility that the policy pendulum may be starting to swing in the other direction. The main source of this change is that voters, and hence politicians, in some of the world's leading economies are having second thoughts about globalisation. They are unnerved by its success in creating new economic and geopolitical challengers. They are discomforted by a rise in inequality and by the perceived competitive pressures arising from trade with low income developing countries. Energy security and environmental concerns add to the mix. The result is a growing pressure for policymakers to act, not necessarily to reverse the process of international economic integration, but to moderate it or reshape it to deal with some of its consequences. The swing of the policy pendulum is certainly not a done deal, but the odds of such a move are on the rise.

The change in mood should not be overplayed, and the most probable policy shifts will still fall short of anything likely to derail globalisation. Despite last year's Dubai Ports World saga, for example, FDI into the United States in 2006 was still up almost 70 % on 2005, and at US$183.6 billion recorded its highest value in six years. In fact, the current stresses and strains look much more like growing pains for the world economy than they do its death throes.

Moreover, many of the forces driving globalisation are likely to persist and so counterbalance any change in policy direction. For example, the expansion of international production networks that has been central to recent growth in international trade has been driven not just, or even primarily, by policy actions (for example lower tariff barriers) but rather by technological change in the form of improvements in telecommunications, transport, and management processes. Technological innovation has similarly been a major driver of financial market innovation and cross-border capital flows. Such forces for integration look set to continue.[93] Past deregulation, too, creates a momentum of its own, partly because some forms of deregulation have snowball effects, whereby they create pressure to deregulate in other areas, and partly by creating winners from the changes, who will then lobby to defend the new status quo.

The lessons learned from the collapse of the nineteenth century version of globalisation should also help policymakers avoid any repeat of that disastrous experience.[94] Granted, there are some worrying parallels between current circumstances and the earlier era. Then, too, globalisation turned out to have major implications for wealth and income distribution that in turn had political consequences that helped fuel a globalisation backlash, and then too, a major supply shock (for China and manufacturing exports substitute the United States and the grain invasion) triggered a protectionist response.[95] But there are also important differences between the two periods, including more social insurance for workers (at least in the developed world) and better-equipped policymakers. The experience of the late nineteenth century and especially the interwar period that followed provides a powerful warning of the perils of unchecked protectionism that should constrain any policy response this time around.

There are four issues to track this year that should provide a useful reading on the evolving policy mood. These are: the state of the Doha round of world trade negotiations; the response of the US Congress to the request to renew the President's TPA; the path of US-China bilateral economic relations, including the aftermath of May's Strategic Economic Dialogue; and China's response to the protectionist backlash in the rich

world. Developments on these fronts should provide a useful guide as to the seriousness of the pressures to rethink globalisation-friendly policies.

What are the policy implications for a country like Australia, which has done particularly well out of the current era of globalisation, and which therefore has a national interest in sustaining it?

First, the repair of the international economic architecture represents a pressing challenge. Working for the replacement of the increasingly anachronistic G7 with the much more representative G-20 as the informal steering committee for the global economy is a good place to start. Advancing reform of the IMF, including the introduction of a simple, transparent quota formula that reallocates voting power according to the changing distribution of economic weight in the global economy, is another useful task. The multilateral trading system is also in urgent need of renovation. The Doha Round is looking likely to mark the last of the giant, set-piece trade negotiations, and a new model for trade liberalisation will be required. While progress in these areas ultimately requires the buy-in of the major powers, both established and rising, countries like Australia still have an important role to play in driving reform, both through the quality of the suggestions they offer, but also because, as smaller players, they can try to perform the role of honest broker in the subsequent debates.

Second, there are useful lessons to be drawn from the 'Australian model' for other countries in terms of how to structure policies and institutions in order to benefit from the new global economy: Australia's success is about much more than the commodity-driven boost to its terms of trade.[96] Australia can also offer itself as a good example of the benefits of international economic integration. It is important that politicians and policymakers from globalisation's winners are fully engaged in the debate over the future of globalisation, to balance the fears of the worriers. Globalisation has been good for Australia, and Australian voices should be heard in its support.

Third, there are areas of domestic policy innovation where countries like Australia can hope to influence international policy debates on some of the issues driving the current globalisation angst. One possibility would be climate change policy, where early adoption of a proposal like the McKibbin-Wilcoxen Blueprint could not only set a powerful international example, but would also have significant national economic benefits.[97]

Finally, to the extent that the changing global mood indicates a growing tendency for the rules of the international economic game to be written at a regional, rather than a global, level, it is important for Canberra to make sure that it is part of the regional process. That means keeping a close watch on the evolution of East Asia's regional economic architecture and doing as much as possible to ensure that the preferred regional model is one that includes Australia.

Notes

1 For example Niall Ferguson, Sinking globalization. *Foreign Affairs,* Vol. 84 No. 2, 2005 and Niall Ferguson, Globalization's second death? *LA Times*, 10 April 2006.

2 See Mark Thirlwell, *After Doha: II. Is globalisation history?* Lowy Institute Analysis. Sydney, Lowy Institute for International Policy, October 2006.

3 Disdier and Head find that the negative impact of distance in trade, far from shrinking, is increasing over time. Anne-Celia Disdier and Keith Head, The puzzling persistence of the distance effect on bilateral trade. *Review of Economics and Statistics* Forthcoming.

4 On the dark side of globalisation — the growth of transnational crime in the form of illegal trade in drugs and arms, people smuggling and money laundering — see Moises Naim, The five wars of globalization. *Foreign Policy,* Vol.134, 2003. These developments have been powered by many of the same engines driving conventional economic integration, including technology and the decline in policy barriers to cross-border transactions. Open borders may also have made the international transmission of infectious diseases faster and easier. For one look at the possible economic consequences of a global pandemic for the world economy, see Warwick J McKibbin and Alexandra A Sidorenko, *Global macroeconomic consequences of avian influenza*. Lowy Institute Analysis. Sydney, Lowy Institute for International Policy, 2006.

5 See for example the discussion in Rawi Abdelal and Adam Segal, Has globalization passed its peak? *Foreign Affairs,* Vol. 86 No.1, 2007.

6 Scott C Bradford, Paul L E Grieco and Gary Clyde Hufbauer, The payoff to America from globalisation. *The World Economy,* Vol. 29 No.7, 2006. Estimates for future gains range from US$450 billion to US$1.3 trillion. Note that other estimates of the gains from trade liberalisation alone tend to suggest much smaller gains.

7 The list is not an exhaustive one. Other candidates for inclusion would include fears about the volatility of international capital flows and worries about immigration. The alliterative sub-headings that follow are a nod to the style of chapter titles in Part IV of Martin Wolf's strong defence of globalisation. Martin Wolf, *Why globalization works.* New Haven and London, Yale University Press, 2004.

8 This trend is the subject of Mark Thirlwell, Angst without frontiers. *Australian Financial Review*, 10 April 2006. available for download at http://www.lowyinstitute.org/Publication.asp?pid=366

9 On China's integration with the world economy see for example Lee Branstetter and Nicholas Lardy, *China's embrace of globalization*. NBER Working Paper 12373. Cambridge MA, National Bureau of Economic Research, 2006. On India's more cautious conversion to the joys of globalisation, see for example Mark Thirlwell, *India: the next economic giant*. Lowy Institute Paper 01. Sydney, Lowy Institute for International Policy, 2004. Note also that while the broad policy advice — integrate with global markets — was correct, the way that both China and India have gone about this task has frequently been different from the standard Western policy prescription.

10 According to the *Oxford Dictionary of Quotations*, while a version of this remark is widely attributed to V I Lenin, it is not found in any of his published works.

11 In 2006 the US current account deficit rose to a record US$856.7 billion (6.5% of US GDP).

12 There is a debate as to whether external imbalances really are a cause for concern. Max Corden, for example, notes that large international current account imbalances are not *necessarily* undesirable for the same reason that trade is not undesirable. Max Corden, Those current account imbalances: a sceptical view. *The World Economy,* Vol. 30 No. 3, 2007.

13 For a strategic thinker's view on the benefits of economic integration see Thomas P M Barnett, *The Pentagon's new map: war and peace in the twenty-first century.* New York, Putnam, 2004. A critique of the more ambitious political convergence argument is James Mann, America's China fantasy. *The American Prospect,* Vol. 18 No. 3, 2007.

14 Samuel P Huntington, Why international primacy matters. *International Security,* Vol. 17 No. 4, 1993. p 72.

15 John J Mearsheimer, China's unpeaceful rise. *Current History,* Vol. 105 No. 690, 2006; John J Mearsheimer, The future of the American pacifier. *Foreign Affairs,* Vol. 80 No. 5, 2001. pp 57-58.

16 Barry C Lynn, War, trade and utopia. *The National Interest,* Vol.82, 2005.

17 Jeffry A Frieden, *Will global capitalism fall again?* Bruegel essay and lecture series. Brussels, Bruegel, 2006. pp 28-30.

18 This point is emphasised in Peter H Lindert and Jeffrey G Williamson, Does globalization make the world more unequal?, in *Globalization in historical perspective.* Chicago, The University of Chicago Press, 2003.

19 Simon Kuznets, Economic growth and income inequality. *American Economic Review,* Vol. 45 No. 1, 1955. Some empirical research has tended to cast doubt on the Kuznets hypothesis, arguing that national income distributions are relatively stable over time. See for example Hongyi Li, Lyn Squire and Heng-fu Zou, Explaining international and intertemporal variations in income inequality. *Economic Journal,* Vol. 108 No. 446, 1998.

20 Rosen provides a discussion of the economics of superstars, whereby relatively small numbers of people tend to dominate their professions and receive huge payoffs. Rosen emphasises the combined effects of imperfect substitutability and technological change. Sherwin Rosen, The economics of superstars. *American Economic Review,* Vol. 71 No. 5, 1981. Frank and Cook have identified the growth of what they describe as 'winner-takes-all markets', which have very similar characteristics to superstar markets. Robert H Frank and Philip J Cook, *The winner-take-all society.* New York, The Free Press, 1995.

21 The Economist, Rich man, poor man. *The Economist*, 18 January 2007.

22 Lawrence H Summers, The global middle cries out for reassurance. *Financial Times*, 29 October 2006.

23 See Richard B Freeman, What really ails Europe (and America): the doubling of the global workforce. *The Globalist*, 3 June 2005. Also Chapter 4 in World Bank, *Global economic prospects 2007: managing the next wave of globalization.* Washington DC, World Bank, 2007.

24 See for example Anastasia Guscina, *Effects of globalization on labor's share in national income*. IMF Working Paper WP/06/294. Washington DC, International Monetary Fund, 2006. Guscina finds that the relative decline in labour's share of income can be explained by a combination of (capital-augmenting) technological progress and greater openness to trade.

25 Paul R Krugman, The great wealth transfer. *Rolling Stone*, 22 December 2006.

26 Ian Dew-Becker and Robert Gordon, Where did the productivity growth go? Inflation dynamics and the distribution of income. *Brookings Papers on Economic Activity* 2, 2005.

27 David H Autor, Lawrence F Katz and Melissa S Kearney, The polarization of the US labor market. *American Economic Review,* Vol. 96 No. 2, 2006. The authors point to the direct impacts on employment demand of technological change, together with the indirect effect of the latter through outsourcing, as an explanation of recent trends.

28 There are several important shortcomings of this statistic, since the measure of income that it is based upon does not take into account various taxes and also excludes some benefits and capital gains.

29 For the view that technology is the key factor see for example, Jagdish Bhagwati, Technology, not globalization, driving wages down. *Financial Times*, 4 January 2007. For a summary of some of the other arguments as to why US inequality might not be a major problem, see Tyler Cowen, Incomes and inequality: what the numbers don't tell us. *New York Times*, 25 January 2007.

30 Stephen Roach, *Power shift*. Global: economic comment, Morgan Stanley Research Global, 8 January 2007.

31 According to the WTO, developing countries' share of world trade in 2005 reached 34 %, its highest level since 1950. On a very broad definition of developing economies (one that includes high income economies like Korea and Singapore) the IMF's Direction of Trade Statistics shows their share in world exports rising from 28 % in 1990 to 43 % in 2005. These are nominal figures, and so in recent years have been boosted by high commodity (particularly oil) prices. Still, statistics on the developing country share of global manufacturing trade also show a significant rise in recent years.

32 See for example, Richard B Freeman, Are your wages set in Beijing?

Journal of Economic Perspectives Vol. 9 No. 8, 1995.

33 Summaries of this debate can to be found in David Greenaway and Douglas Nelson, Globalization and labour market adjustment. *Oxford Review of Economic Policy* Vol. 16 No. 3, 2000 and Lindert and Williamson, Does globalization make the world more unequal? pp 257-261.

34 Cited in Guillermo de la Dehesa, *Winners and losers in globalization.* Oxford, Blackwell, 2006.

35 For example Louis Uchitelle, To mend the flaws in trade. *New York Times*, 30 January 2007. China's success has also prompted debate as to the possibility of a squeeze on middle-income developing countries that are also exporters of labour-intensive manufactures.

36 Charles Schumer and Paul Craig Roberts, Second thoughts on free trade. *New York Times*, 6 January 2004. For a critique of their arguments see Douglas A Irwin, 'Outsourcing' is good for America. *Wall Street Journal*, 28 January 2004.

37 This is the basic message of Paul A Samuelson, Where Ricardo and Mill rebut and confirm arguments of mainstream economists supporting globalization. *Journal of Economic Perspectives,* vol. 18 No. 3, 2004. Samuelson sketches out a model that shows how an improvement in productivity which allows (say) China to start producing goods that were previously produced by (say) the United States can make the latter worse off by increasing the supply of the products in question. For an extension of the implications of this kind of process to a case where economies of scale are in operation, see Ralph E Gomory and William J Baumol, *Global trade and conflicting national interest.* Cambridge MA, MIT Press, 2000.

38 Defining a 'strategic' industry is not necessarily straightforward. It is worth remembering, for example, that similar fears were expressed in the United States in the 1980s over the loss of microchip production to East Asia.

39 Grossman and Rossi-Hansberg make the case for a 'new paradigm' in which the previous focus on trade in goods is replaced by one on trade in tasks. Gene M Grossman and Esteban Rossi-Hansberg, *The rise of offshoring: it's not wine for cloth anymore* (paper presented at the Federal Reserve Bank of Kansas symposium: The new economic geography: effects and policy implications, Jackson Hole, Wyoming, 24-26 August 2006). Note that the theoretical framework proposed by their paper is broadly *positive* on the

implications of offshoring for workers, although their empirical work is less reassuring. For a statement of the orthodox position that there is no essential difference between the two kinds of trade, see Jagdish Bhagwati, Arvind Panagariya and T N Srinivasan, The muddles over outsourcing. *Journal of Economic Perspectives,* Vol. 18 No. 4, 2004.

40 On the longer term impact of offshoring, see for example Alan Blinder, Offshoring: the next industrial revolution? *Foreign Affairs,* Vol. 85 No. 2, 2006. Also Stephen S Cohen and J Bradford DeLong, Shaken and stirred. *The Atlantic Monthly,* Vol. 295 No. 1, 2005.

41 According to US Commerce Department data. Chinese data put the bilateral deficit at US$177.5 billion. The discrepancy reflects different treatment of value-added exports from Hong Kong.

42 While most of the focus has been on minerals and especially energy, there are other important candidates. According to the FAO, for example, some 75 % of the world's marine fish stocks are now being exploited either at or above their maximum sustainable level. FAO, *The state of world fisheries and aquaculture.* Rome, Food and Agriculture Organization (FAO), 2004. Cited in Chapter 5 of World Bank, *Global economic prospects 2007: managing the next wave of globalization*.

43 This despite the fact that most energy experts seemed to doubt that there was any security risk arising from the proposed deal given the relatively small size of Unocal.

44 Thomas Malthus, *An essay on the principle of population.* London, Penguin Books, 1983 (Modern edition, first published 1798).

45 On scarcity and the constraints to growth, the classic reference for this period is D H Meadows, D L Meadows, J Randers and W W Behrens III, *The limits to growth: a report for the Club of Rome's project on the predicament of mankind.* New York, Universe Books, 1972.

46 Shane Streifel, *Impact of China and India on global commodity markets: focus on metals and minerals and petroleum. Background paper for Dancing with Giants: China, India and the global economy.* Washington DC, World Bank, 2006.

47 Asian Development Bank, Developing Asia's imprint on global commodity markets, in *Asian Development Outlook 2006 Update.* Manila, Asian Development Bank, 2006.

48 Of course, for commodity exporters, including developed economies like Australia, this is all good news.

49 The Economist, Oil's dark secret. *The Economist*, 10 August 2006.

50 See for example Mark Thirlwell and Anthony Bubalo, *Energy insecurity: China, India and Middle East oil*. Lowy Institute Issues Brief. Sydney, Lowy Institute for International Policy, 2004; David Zweig and Bi Jianhai, China's global hunt for energy. *Foreign Affairs,* Vol. 84 No. 5, 2005; and Wu Lei and Shen Qinju, Will China go to war over oil? *Far Eastern Economic Review,* Vol. 169 No. 3, 2006.

51 James K Boyce, Green and brown? Globalization and the environment. *Oxford Review of Economic Policy,* Vol. 20 No. 1, 2004. Gareth Porter reports empirical evidence suggesting that it is in rapidly industrialising economies, rather than countries which already enjoy high standards, that competitiveness pressures exert downward pressure on standards, creating a 'stuck at the bottom' problem, rather than a race to the bottom. Gareth Porter, Trade competition and pollution standards: "race to the bottom" or "stuck at the bottom"? *The Journal of Environment and Development,* Vol. 8 No. 2, 1999.

52 In a critique of the race to the bottom thesis, David Wheeler reports some evidence that trends in air quality in major developing-country recipients of foreign direct investment like China, Brazil and Mexico have actually improved during the globalisation period. David Wheeler, Racing to the bottom? Foreign investment and air pollution in developing countries. *The Journal of Environment and Development,* Vol. 10 No. 3, 2001.

53 Alasdair MacBean, China's environment: problems and policies. *The World Economy,* Vol. 30 No. 2, 2007.

54 Jianguo Liu and Jared Diamond, China's environment in a globalizing world. *Nature,* Vol. 435 No. 30, 2005. China has already begun to take action to reduce emissions of sulphur by substituting away from high sulphur coal, by closing small, high sulphur coal mines, with direct controls on SO2 emissions, by implementing pilot schemes for SO2 emission charges and pilot schemes for SO2 emissions trading. Warwick J McKibbin, *Environmental consequences of rising energy use in China*. Working Paper in International Economics No. 8.05. Sydney, Lowy Institute for International Policy, 2005.

55 Richard McGregor and Jo Johnson, China and India face up to curbs on carbon. *Financial Times*, 26 February 2007.

56 Figure 6.1 in Kevin A Baumert, Timothy Herzog and Jonathan Pershing, *Navigating the numbers: greenhouse gas data and international climate policy.* World Resources Institute, 2005.

57 Ibid. Figure 2.1

58 Zmarak Shalizi, Energy and emissions: local and global effects of the rise of China and India, in *Dancing with giants: China, India and the global economy*. L Alan Winters and Yusuf Shahid (eds), Washington DC, World Bank and Institute of Policy Studies, 2007.

59 The CDM allows countries with emission reduction targets to invest in emission reduction projects in developing countries (which have no targets) in order to earn emission reduction credits that can be set against domestic emission reduction targets or sold on. In this way, the CDM is also supposed to support the transfer and development of low-emission technologies to developing countries.

60 McKibbin, *Environmental consequences of rising energy use in China*.

61 Thomas L Friedman, *The Lexus and the olive tree.* London, HarperCollins, 1999. p 93.

62 The following discussion draws upon the arguments presented in Mark Thirlwell and Malcolm Cook, *Geeing up the G-20*. Lowy Institute Policy Brief. Sydney, Lowy Institute for International Policy, 2006.

63 The G7 is an informal group of finance ministers and central bank governors from the US, Japan, Germany, UK, France, Italy and Canada which has its origins in the 1970s, when the then G5 started to meet. The first formal G7 meeting was in 1986. Its members meet regularly to assess developments in the global economy and international financial system. The IMF is older, a product of the July 1944 Bretton Woods conference, and has become the main venue for international discussion of both national policy settings and trends in the world economy.

64 Thirlwell and Cook, *Geeing up the G-20*.

65 A detailed description of the IMF quota and voting system and country representation is given by Karen Taylor, Craig Tipping and Adam McKissack, *IMF quotas, representation and governance*. Treasury Working Paper 2004-03. Canberra, Australian Treasury, 2004.

66 The Economist, Funding the fund. *The Economist*, 1 February 2007.

67 Rodrigo de Rato, *Progress in implementing the Fund's Medium-Term Strategy*. Speech at the Foreign Correspondents Club, Tokyo, 3 August 2006. Washington DC, International Monetary Fund, 2006.

68 The World Trade Organization (WTO) was established by the Uruguay Round as a successor to the General Agreement on Tariffs and Trade (GATT). Its role is to administer world trade rules. For a more detailed discussion on the challenges facing the WTO, see Mark Thirlwell, *The new terms of trade*. Lowy Institute Paper 07. Sydney, Lowy Institute for International Policy, 2005, especially Chapter 2.

69 See for example Alan Beattie, Boxed in. *Financial Times*, 7 June 2005.

70 Peter Sutherland, Jagdish Bhagwati, Kwesi Botchwey, Niall Fitzgerald, Koichi Hamada, John H Jackson, Celso Lafer and Thierry de Montbrial, *The future of the WTO: addressing institutional challenges in the new millennium. Report by the Consultative Board to the Director-General Supachai Panitchpakdi.* Geneva, World Trade Organization, 2005.

71 Mark Thirlwell, *After Doha: I. The search for Plan B*. Lowy Institute Analysis. Sydney, Lowy Institute for International Policy, September 2006.

72 John Gerard Ruggie, Trade, protectionism and the future of welfare capitalism. *Journal of International Affairs,* Vol. 48 No. 1, 1994.

73 Donatella Gatti and Andrew Glyn, Welfare states in hard times. *Oxford Review of Economic Policy,* Vol. 22 No. 3, 2006.

74 Vito Tanzi, Globalization and the work of fiscal termites. *Finance and Development,* Vol. 38 No.1, 2001.

75 Hans-Werner Sinn, The new systems competition. *Perspektiven der Wirtschaftspolitik,* Vol. 5 No. 1, 2004.

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