



Asia Program

SPECIAL REPORT

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The Policy Space Debate: Does a Globalized and Multilateral Economy Constrain Development Policies?

EDITED BY BHUMIKA MUCHHALA

ABSTRACT This Special Report asks whether multilateral economic policies constrain the ability of developing countries to choose the best mix of economic policies for achieving sustainable and equitable development. **Jomo Kwame Sundaram** illustrates the significance of policy space for national development strategies, and assesses the principal sources of constraints imposed by international financial institutions (IFIs) on policy space in developing countries. **Heiner Flassbeck** contends that intermediate exchange rate regimes and the development of a multilateral framework for exchange rates would enable developing countries to better align their monetary policies with their development priorities. **Carlos Correa** links intellectual property rights (IPR) rules in the global trade regime to equitable development by presenting several counter-arguments to the dominant proposition that IPRs are necessary to promote knowledge and innovation, and by providing a historical analysis of IPR policy. **Elaine Zuckerman** demonstrates the impact of IFI loans and projects on women and girls through country case studies, arguing that IFI-imposed conditionalities intensify the feminization of poverty through, for example, the privatization of essential services.

INTRODUCTION

BHUMIKA MUCHHALA

The debate on the importance of policy space for national development strategies has gained significant momentum in recent years, particularly among developing country representatives in international forums. The argument for policy space states that developing countries need the freedom to choose the best mix of policies possible for achieving sustainable and equitable development given their specific national conditions. This argument reflects the idea that governments should have the ability to evaluate the trade-offs between the benefits of engagement in the global economy versus the loss of policy space that often accompanies

international rules and agreements. In order to better understand such an argument, a working definition of policy space is necessary. One such definition is that policy space, for developing countries, “is about the freedom to choose the best mix of policies possible for achieving sustainable and equitable economic development given their unique and individual social, political, economic, and environmental conditions.”¹ Policy space refers to the scope a nation has for building its own national development strategy and its relationships with the world economy and markets.

The three international law principles that validate the concept of policy space are the sovereign equality of states, the right to development, and the principle of special treatment for developing coun-

The argument for policy space states that developing countries need the freedom to choose the best mix of policies possible for achieving sustainable and equitable development.

tries.² These principles are reflected in the charter adopted by the United Nations Conference on Trade and Development (UNCTAD) at its first meeting in June 1964. UNCTAD arose from the demands of poorer countries to establish a trade and development body that addressed their needs and concerns. General Principle Fifteen in UNCTAD's 1964 charter states that developing countries should receive special and differential treatment according to their particular stage of development.³ When applied to policy space through its third principle of special treatment, the charter's General Principle Fifteen contends that some international rules and commitments may not be appropriate for certain developing countries at their respective levels of development. Forty years after these principles were first endorsed by UNCTAD, they have again appeared in public discourse on international development. UNCTAD's XI conference in Sao Paulo in June 2004 demonstrated that these principles are just as—or even more—relevant today, as multilateral rules for achieving development continue to fall short of their promises.

THE NORTH-SOUTH DEBATE ON POLICY SPACE

The objective of the UNCTAD XI conference was to produce a declaration by developing countries on globalization, trade and development strategies. The Negotiated Text of the UNCTAD XI conference in 2004 generated dispute between developed and developing countries. The disagreement focused on one of the central tenets of the text in paragraph 18, which states that increasing interdependence in a globalizing world and the emergence of rule-based international economic regimes have meant that the space for national economic policy in trade, macro-economic, and industrial development is now governed by international commitments, and the prior-

itization of global market considerations over national development.⁴ Developing countries' call for policy space to carry out their national development strategies has struck a controversial chord in developed countries, who argue that policy space cannot be used as a roadmap for UNCTAD's work nor as a principle in multilateral economic frameworks as it may appear to suggest that developing countries can opt out of international rules and agreements.⁵ Despite the disagreements between rich and poor countries, the UNCTAD XI conference underscored the need to strike a balance between the objectives of efficiency and equity, in that both the market and the state have crucial roles to play in the development process.

Consequently, global civil society and international development forums, such as the United Nations (UN) World Summit in September 2005, have reinforced the international development community's commitment towards enabling developing countries to pursue their own development strategies. The 2006 Trade and Development Report by UNCTAD, titled "*Global partnership and national policies for development*," highlighted a paradox between the global trading and financial regimes.⁶ While multilateral and bilateral trade rules often impose constraints on the ability of states to manage foreign investment or use performance requirements such as local-content sourcing, the absence of a multilateral arrangement in international financial liberalization makes it difficult for states to enforce selective capital controls, for example. The UNCTAD report urged maintaining a balance between sovereignty in national economic policy-making and multilateral commitments.

With the purpose of bridging the gaps between various policy alternatives already proposed by economic development scholars and advocates and the political realities of enacting them in the world economy, the Woodrow Wilson Center's Asia Program

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prominent scholars of Asia interact with one another and with policy practitioners to further understanding of the peoples, traditions, and behaviors of the world's most populous continent.

hosted a symposium on December 14, 2006. The following compilation of four essays by the speakers at the conference aims to offer four analyses on the global economic constraints that inhibit national policy space for development goals.

FOUR PERSPECTIVES ON POLICY SPACE

The conference keynote speaker, **Jomo Kwame Sundaram**, is the assistant secretary-general for economic development at the United Nations Department for Economic and Social Affairs. He stresses the significance of policy space for national development strategies, and assesses the principal sources of external, global constraints to national policy space. He acknowledges the importance of the UNCTAD XI meeting in 2004 and the World Summit in 2005 for the international recognition of—and commitment to—ensure policy space for developing countries to pursue their development strategies. Jomo illustrates that economic growth in developing countries during the 1980s and 1990s has been considerably slower in contrast to the 1960s and 1970s. He argues that this is due to a considerable extent to economic liberalization policies and market reforms required by the international financial institutions (IFIs)—namely the World Trade Organization, the World Bank and the International Monetary Fund (IMF)—that reduce flexibilities for developing countries. The key reforms occur in the areas of trade liberalization, financial liberalization, and contractionary macroeconomic pressures which reduce the role and fiscal capacities of governments. The privatization of state-owned enterprises and public services, particularly in the 1990s, has had negative repercussions on economic development as some essential services and goods have become harder to access. Jomo contends that due to greater market influences, the macroeconomic policies that are adopted by developing countries today are pro-cyclical, which increases national vulnerability to economic crises.

Trade liberalization has not benefited the majority of developing countries because the terms of trade have moved against developing countries through the unequal relationships between primary and manufactured products, and between tropical and temperate agricultural products. The strategic use of trade policy, which is now restricted by global trade rules to a large extent, is crucial for development. Jomo points out that in post-World War II Northeast Asia, as in many

other parts of the world, effective conditional protection on export promotion was instrumental to spurring industrialization. Due to the structural reforms in trade liberalization that have been carried out over the last two decades, many lesser developed countries have experienced a significant collapse of manufacturing capacity. International financial liberalization, Jomo asserts, constrains fiscal space through the adoption of monetary policies that are counter-inflationary, which often have a deflationary effect on economic growth. Instead of generating financial flows from capital-rich to capital-poor countries, international financial liberalization has resulted in a flow of funds in the opposite direction. Furthermore, Jomo posits that financial liberalization has often led to an undermining of institutions that have a developmental purpose, such as national development banks. The ability of central banks and finance ministries to implement counter-cyclical instruments and institutions has also been restricted through financial liberalization.

Jomo argues that counter-cyclical macroeconomic policies—which promote growth and employment as fiscal policy objectives of the government—would strengthen the ability of the global economy to reduce global inequality. The conventional approach to one of the most crucial aspects of policy space—that of fiscal space—is to prioritize the ability to service debt above the ability to increase public expenditures. The imperative to promote growth and employment as fiscal objectives is undermined by this approach, as the use of fiscal policy to offset cyclical downturns is often restrained through the rationale that such fiscal policy will hurt government solvency. The counter-argument, he asserts, is that growth creates fiscal solvency, and not vice versa. Furthermore, achieving development goals necessitates medium-term expenditure planning, and thus medium-term commitments to financing, including more stable and predictable aid. In conclusion, Jomo stresses that if the poverty reduction strategies of the World Bank are to genuinely address poverty, employment generation needs to be included and prioritized in these strategies.

Heiner Flassbeck, director of the Division on Globalization and Development Strategies at UNCTAD, addresses the macroeconomic and financial policy framework of globalization. Flassbeck situates his argument within the context of global economic crises over the last two decades, spurred by financial and trade liberalization—or the free mobility of private capital and goods across open borders. Global

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trade and financial liberalization in developing countries during the 1980s and 1990s was carried out under the policy framework of “getting the prices right.” However, there is no framework to address “the most important international price, the exchange rate, and the closely related interest rate.” Exchange rates that are either rigidly fixed, or pegged, to the dollar as well as those that are freely floating have encountered monetary instability which substantially affects the health of the economy. Thus, “intermediate” exchange rate regimes have become the preferred option in most developing countries with open capital markets. Flassbeck supports such intermediate regimes, which “offer more room for manoeuvre” when financial market instabilities occur as well as enable exchange rate adjustments that better support a country’s development strategy. Such an intermediate regime reflects the implementation of national policy space, while the risks and constraints that emerge with financial liberalization stimulate a critical debate on the monetary and financial policies available for national governments to implement. Flassbeck argues that a multilateral monetary system for exchange rates is required in order for the international financial system to steer clear of competitive depreciations and other monetary distortions. Depreciations and distortions impact the productive functioning of the international trading system, on which much of global and national level economic progress thrives. The rationale for such a multilateral exchange rate system is that the exchange rate is by definition “a multilateral phenomenon,” where any change in its value inevitably creates multilateral repercussions.

Flassbeck explains that the risk of a global deflation due to the imbalance in the global economy is a serious concern, as the increasing external deficit of the United States may trigger a strong speculative wave towards dollar depreciation. A dollar depreciation could subsequently generate a downwards pressure on other major global currencies. Such a depreciation of the dollar would help re-balance the United States economy. However, given the pattern of global growth—and the dependence that global growth has on American consumption and imports—a marked slowdown in exports to the U.S. would have global deflationary repercussions. This has the dangerous potential to unravel the momentum in development progress and poverty reduction seen in developing countries in recent times without any fault of their own.

In the third essay, **Carlos Correa**, who is a professor and the director of the Center for Interdisciplinary Studies of Industrial Property Law and Economics at the University of Buenos Aires, focuses on the salient issue of intellectual property rights (IPRs) and its links to equitable development. Correa contends that the global regime on IPRs needs to integrate a development dimension and address critical public policy concerns in order to enable developing countries to promote and produce knowledge and innovation, access essential medicines, as well as access the technology and information necessary to industrialize and develop. Intellectual property protection creates exclusionary rights that limit the access to—and the use of—a vast array of intellectual works, technologies, and products needed for social and economic development in developing countries. Correa highlights several counter-arguments to the dominant argument that IPRs are necessary to promote knowledge-creation, innovation, and creativity through the allocation of economic rewards for the producers of knowledge. He contends that competition can also lead to innovations in product and process—such as in the fast-paced industry for semiconductors—where IPRs do not play a crucial role as incentives for innovation. Another salient point is that non-IPR factors such as lead time, the capacity levels necessary to imitate knowledge processes, as well as established customer loyalty, impact the ability to replicate knowledge even in the absence of IPRs.

A historical comparison of IPR enforcement reveals that when today’s developed countries were industrializing in the 19th century, they had vast flexibilities to design their own IPR systems, protecting local producers of knowledge, discriminating against foreign producers through patent fees, avoiding the application of medical patents, and mimicking existing information and technology innovations for their own industrialization. In the current global trade regime the Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement, under the auspice of the World Trade Organization (WTO), harmonizes binding IPR rules globally, prohibiting developing countries from designing IPR systems that are in line with their development requirements, and that reflect the flexibilities that today’s industrialized countries had when they were developing. Many developing countries have consistently argued that IPR implementation is not conducive to tech-

nological—and thus industrial—development, and that patents have grave implications for accessing essential medicines. Developing countries contend that more flexibility is needed in the implementation of IPRs and thus initiated the drafting of the Declaration on TRIPS and Public Health at the 2001 WTO Ministerial meetings in Doha, which allows for some key flexibilities in the case of public health emergencies. However, the advent of regional and bilateral free trade agreements with a wide array of countries extends IPR rules and commitments beyond what is required by TRIPS in the WTO.

As president of Gender Action, a non-profit organization dedicated to promoting gender equality and women's rights in all IFI investments and transactions, **Elaine Zuckerman** illustrates the impact of IFI loans and projects on women and girls through country case studies. Zuckerman argues that conditionalities attached to IFI loans and projects not only impinge on national sovereignty by requiring governments to comply with their creditors' notions of how to reform economic, financial, and trade policies, but also contribute to the feminization of poverty. The national policy space available to pursue development objectives is impeded through, for example, the privatization of services or the requirement to reduce or eliminate tariffs without reciprocation by developed countries. Consequently, civil society worldwide has criticized IFI policy conditionalities for their harmful social and gendered impacts. Zuckerman alludes to the fact that 70 percent of the world's poor are women, and asserts that these women shoulder a disproportionate amount of the economic and social burdens that accompany IFI policy conditionalities.

Country-level case studies of gender impacts are drawn from the Democratic Republic of Congo (DRC), Malawi, Mozambique, Tanzania, Serbia and Montenegro through an array of IFI projects and policy reforms. These range from the privatization of the national mining sector in the DRC, the national textile sector in Serbia and Montenegro, the state grain reserves in Malawi, or public water facilities in Tanzania, as well as new labor laws that increase labor flexibilities in Mozambique. Zuckerman contends that the country-level examples demonstrate that a key function of IFI conditionalities is to open up developing country markets to profitable private sector investments. In IFI loans the main beneficiaries, Zuckerman states, have been the private sector actors that win IFI contracts, not the poor whom the IFIs

claim are the beneficiaries. IFI financing has resulted in the disproportionate concentration of asset ownership and income distribution gaps that have widened in most countries since the late 1980s. A major driver of poverty, stemming from unequal income distribution, has been the negative impacts of IFI policies and loans that cater to the interests and priorities of the political elite and the private sector before they contribute to the vast majority of the world's population, living in developing countries. Zuckerman concludes that civil society and governments worldwide must hold the publicly-financed IFIs accountable. Initiating an end to the ability of IFIs to occupy poor countries' policy space through ending conditionalities and debt would constitute important progress.

The four essays presented in this report each highlight a specific set of dynamics that shape and constrain international development. Jomo outlines the policy frameworks of the IFIs that hinder the full implementation of national development strategies; Flassbeck illustrates the detrimental aspects of global monetary and financial structures and recommends a multilateral framework for exchange rate regimes that is more developmental; Correa demonstrates how intellectual property rights are inextricably linked to development; and, Zuckerman highlights the gender-specific impacts of IFI policies. A consistent element across these four essays is the articulation of multilateral economic policies and practices which systematically constrain the potential adoption of developmental policies. Such analyses may help to target both multilateral and country-level efforts to overcome the obstacles to equitable, long-term development.

POTENTIAL AVENUES OF POLICY SPACE EXPANSION

Recently, several avenues have emerged through which national policy space may be able to expand in new ways. Large developing countries are speaking out for more decision-making power and real policy reform in the creation of multilateral rules and policy agendas in the World Bank, the IMF and the WTO. The weakening of the IMF's policy influence, legitimacy and relevance across many parts of the Global South is one of the most critical changes in the international financial system. Recently, several major borrowers from the IFIs, such as Brazil and Indonesia, have opted to repay IMF and World Bank loans before they were due. Since the Asian financial crisis of 1997–98, many East and

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National policy space is ultimately about the freedom and flexibility of development policy choice centered on the three international law principles of national sovereign equality, the right to development, and special and differential treatment.

Southeast Asian countries have built up vast currency reserves and achieved current-account surpluses in order to indemnify themselves against the policy influence of the IFIs. At the same time, smaller developing countries—particularly in sub-Saharan Africa—do not have the same level of economic security and bargaining power that larger middle-income countries have and are still recipients of IFI loans and credit and the policy conditionalities that accompany it. Assessing the policy space question in lesser-developed countries (LDCs) is thus a central development question.

Recent debt cancellations of LDCs are significant because they have the direct potential to expand fiscal space from resources saved, providing opportunities to craft macroeconomic policies that are coherent with national developmental goals. Debt relief could imply less balance of payments problems for LDCs, potentially leading to a decreased need for, and dependence on, external resources. This opens up possibilities for fiscal policy alternatives, such as expansionary public budgets and progressive taxation policies. Debt relief could also diversify the sources and forms of financing for low-income countries. Some possibilities are regional monetary funds, bilateral financing facilities, international financial markets, and a wider pool of official bilateral and multilateral creditors. Such a diversification of financing could enable countries to obtain resources on favorable terms, particularly through the decoupling of financing and policy conditionalities. LDCs could take advantage of this policy space expansion to undertake a cost-benefit analysis of various financing sources to assess what best suits their national priorities.

REMEMBERING THE “DEVELOPMENTAL STATES”

In efforts to create and apply alternative economic and social policy options, it is important to recall how the developed countries of today achieved development. In marked contrast to the reduced role of the state in today’s market-led development strategies, the developmental states of East Asia—particularly Japan, Korea, Taiwan, Hong Kong, and Singapore—employed strategic and flexible growth strategies through a strong national government. East Asian developmental states stressed the role of the government in managing the market. Instead of prioritizing foreign direct investment (FDI) and tariff reductions, Korea and Taiwan steered their growth through active industrial policies where the state set export targets

and provided subsidies to local firms in order to stimulate positive spillovers in the national economy, especially in technology-driven sectors where the economic value was highest. China has been able to channel private investment in its township and village enterprises through partnerships between investors and local state authorities, rather than through private property rights. One of the key elements of developmental states is the diversification and dynamism of industrial production that focused on the needs of the real economy.

When Western industrialized countries were developing, they also used active industrial policies, subsidies and tariff protection in order to spur economic growth. Indeed, it was the first Treasury Secretary of the United States, Alexander Hamilton, who proposed the argument for infant industry protection.⁷ The historical experiences of developed countries could potentially open up a comparative analysis on development strategies that could allow developing countries to make more informed choices.

ALTERNATIVE POLICY VISIONS

Real development calls for much more than institutional change and economic policies—it calls for the transformation of society towards local ownership, bottom-up participation, the inclusion of the most marginalized members of society, and consensus building. National policy space is ultimately about the freedom and flexibility of development policy choice centered on the three international law principles of national sovereign equality, the right to development, and special and differential treatment for developing countries. However, developing countries also need to strengthen their political will and coordinate among different actors across the nation to build their national development strategy, and to consequently implement it with accountability and transparency mechanisms in place. This involves a collective vision of what a nation’s society and economy will look like ten, twenty, thirty years down the road and how this vision can be achieved over time through the participation of the various groups in society.

Integration into the global economy can provide the benefits of multilateralism to developing countries through many ways, however, the precondition is that this integration should be based on a nuanced assessment of the trade-offs to national development policies and priorities. Debt cancellation and the decreasing

need of middle-income developing countries for IMF loans are avenues through which national policy space may be able to expand. There is an increasing level of articulation by developing country leadership of the importance of the ability to choose and implement the most appropriate economic policies for their national development. Given this context, the argument, principles, history, and empirical evidence for national policy space are only becoming more crucial to achieve equitable and sustainable development across all developing countries in the Global South.

ENDNOTES

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POLICY SPACE? OVERCOMING CONSTRAINTS TO PURSUING NATIONAL DEVELOPMENT STRATEGIES

JOMO KWAME SUNDARAM



INTRODUCTION

Policy space for national development strategies has been recognized as indispensable to development by recent events in the international development community. At the UNCTAD XI meeting in Sao Paulo in 2004, the inter-

national community strongly affirmed the importance of policy space in realizing development aspirations, particularly for developing countries. At the World Summit in September 2005, the international community once again reaffirmed its commitment for ensuring policy space for developing countries to pursue their own national development strategies. This underscores the question of national ownership in relation to the problems associated with existing policy prescriptions and packages, particularly with what are termed “poverty-reduction strategies.” The issue of policy space is framed in this context.

The World Bank’s Independent Evaluation Office recently released a report acknowledging the developmental consequences of the policy conditionalities of international financial institution (IFI) loans and projects. There has been a nominal decrease in the number of conditionalities imposed in recent years. However, this nominal decrease in conditionalities attached to loans and projects has been exaggerated by three factors. First, by using the mid-1990s rather than the more recent period as the base year, the decline seems greater than it actually is. Second, with greater “bunching,” a number of conditionalities are packaged as one condition. This means that while there is a superficial nominal decline in the number of conditionalities, the real number of conditionalities may not have decreased due to such bunching. Thirdly, there has been a shift in emphasis to “benchmarking.” Consequently, even though there might not be as many conditionalities,

benchmarks have become very important signaling devices for disciplining governments, with very similar effects as conditionalities.

GROWTH DIVERGENCES

The pattern of development in the second half of the twentieth century is illustrated by Figure 1 on the following page. National income per capita in developing countries has generally declined in all regions of the world, except Asia. If you remove China from Asia, Asia also experienced a relative decline in national income per capita. The longest collapse has been in sub-Saharan Africa, which suffered a long-term decline in the last quarter of the twentieth century. However, the collapse in Eastern Europe in the 1990s, and in Latin America over the last two decades of the 20th century, has also been dramatic. In recent years, however, many countries in Africa have fared reasonably well and this is part of a larger trend of developing countries generally doing quite well since 2001.

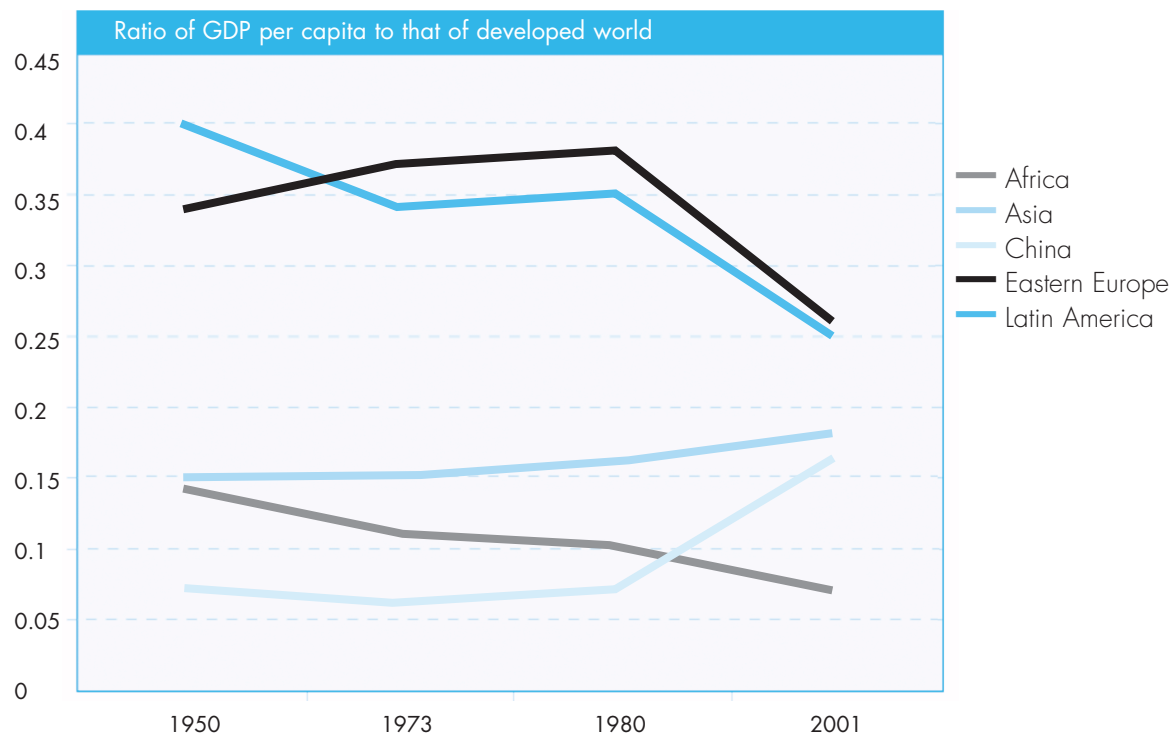
However, this is not due to the economic reform policies imposed on developing countries by IFI loans, credit, and investment. Rather, recent developing country growth results from being able to take advantage of higher commodity prices, particularly in the second half of the 1970s. Much of Latin America’s economic growth was quite rapid for a period, particularly before World War II. Until the 1970s, Brazil had had one of the highest growth rates in the world for half a century. While a few developing countries have experienced rapid economic growth, most have fared poorly towards the end of the 20th century.

Figure 2 underscores the significance of China—once China is omitted from the analysis a distinctly different trend in world income inequality appears. The rapid growth of China in recent years has significantly affected the world distribution of income. Figure 3 provides an indication of world inequality in the early 1960s. The poorest 20 percent of countries had an aver-

Policy space for national development strategies has been recognized as indispensable to development.

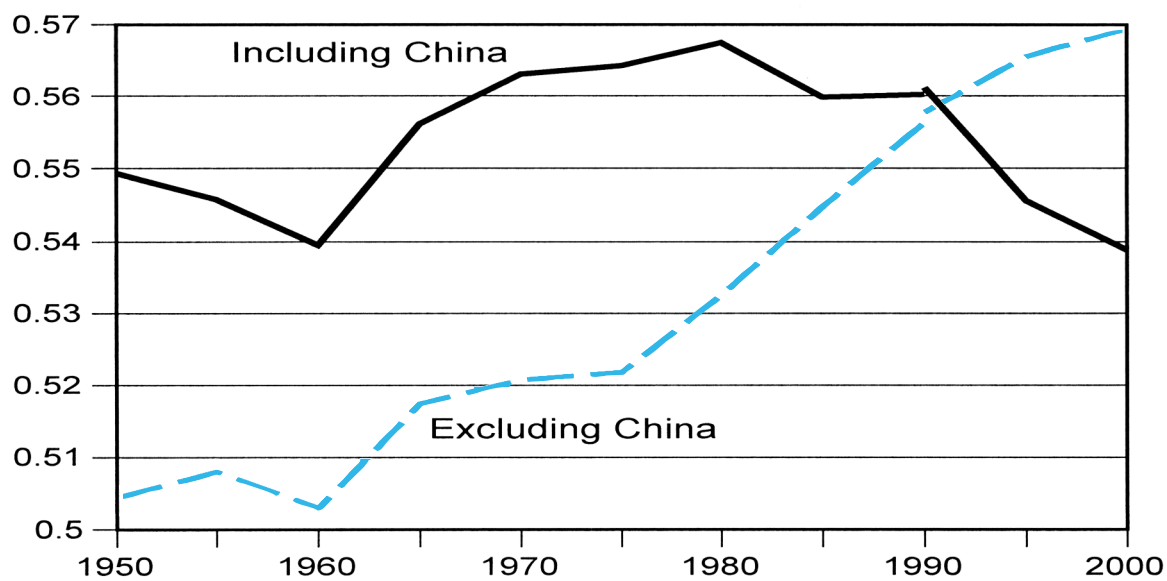
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Figure 1. Ratio of GDP per capita to developed countries



Source: United Nations Department for Economic and Social Affairs, *World Economic and Social Survey 2006*.

Figure 2. Inter-Country Gini Coefficients (an indicator of inequality) with and without China



Source: Jomo and Baudot, *Flat World, Big Gaps: Economic Liberalization, Globalization, Poverty and Inequality*, 2007.

Three particular policies have been especially influential in reducing the policy space for developing countries, namely trade liberalization, financial liberalization, and contractionary macroeconomic pressures.

age of US \$212 per capita income and this increased by about a quarter over four decades to US \$267, whereas for the richest 20 countries, per capita income soared from US \$11,000 to about US \$32,000.

A three-dimensional representation of global income distribution is provided by Figure 4, where the bottom axis represents income groups, with the rich on the left and the poor on the right. The diagonal attempts to capture the variation among countries, with richer countries further away and poorer countries closer to the foreground. The poorest segments of world populations, in the poorest countries, are located in the front corner of the chart, while the skyscraper at the back refers to the richest people in the richest countries. A recent UNU-WIDER (2006) study has demonstrated that approximately 2 percent of the world's population owns half the wealth in the world. The unequal distribution of wealth is clearly worse than the unequal distribution of income.

Figure 5 demonstrates global inequalities in private expenditure and consumption, while Figure 6 demonstrates that economic growth has been slower in the recent period, particularly in the 1980s and 1990s, in contrast to the 1960s and 1970s, often associated with what Keynesians refer to as "the Golden Age." Welfare improvements have also been more modest due to the reduced role and fiscal capacities of governments in service provision. Thus, poverty reduction has been slower, not only due to less

growth, but also due to worsening income distribution. The bar charts of Figure 3 indicate how the slower growth of the recent period has affected different income groups. Generally most income groups experienced less growth in the 1980s and 1990s, compared to the 1960s and 1970s.

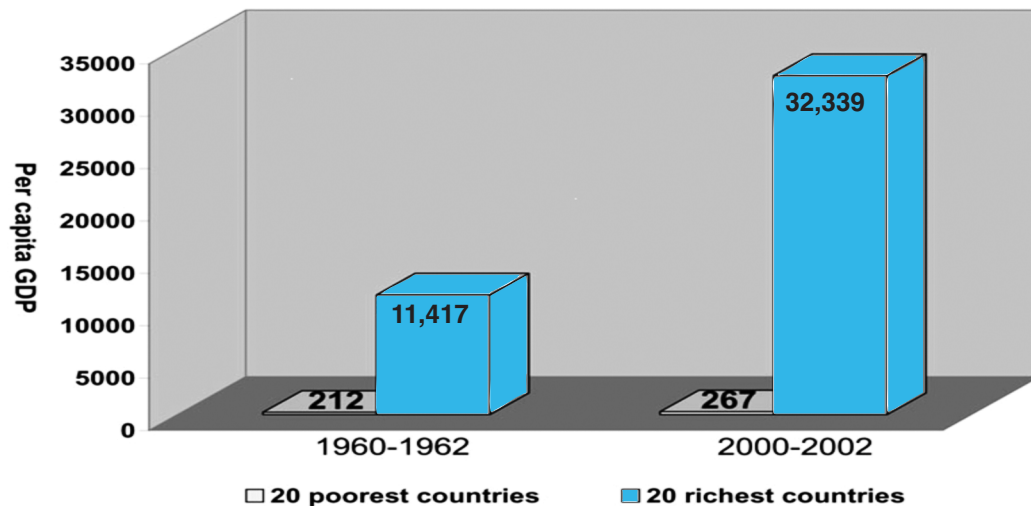
The slower growth in the more recent period has been principally due to the reforms associated with "structural adjustment." Structural adjustment refers to liberal market reforms often required by the Bretton Woods Institutions, but also by other international financial institutions, as a condition for access to loans.

Three particular policies have been especially influential in reducing the policy space for developing countries, namely trade liberalization, financial liberalization, and contractionary macroeconomic pressures. Developing country finance ministers and central bank governors find themselves increasingly subject to signals from the market, where financial interests strongly oppose consumer price inflation.

Such market signals result in macroeconomic policies that are subject to strong contractionary influences. There is also a tendency, due to greater market influences, to adopt macroeconomic policies which tend to be more pro-cyclical than in the macroeconomic policies of the past.

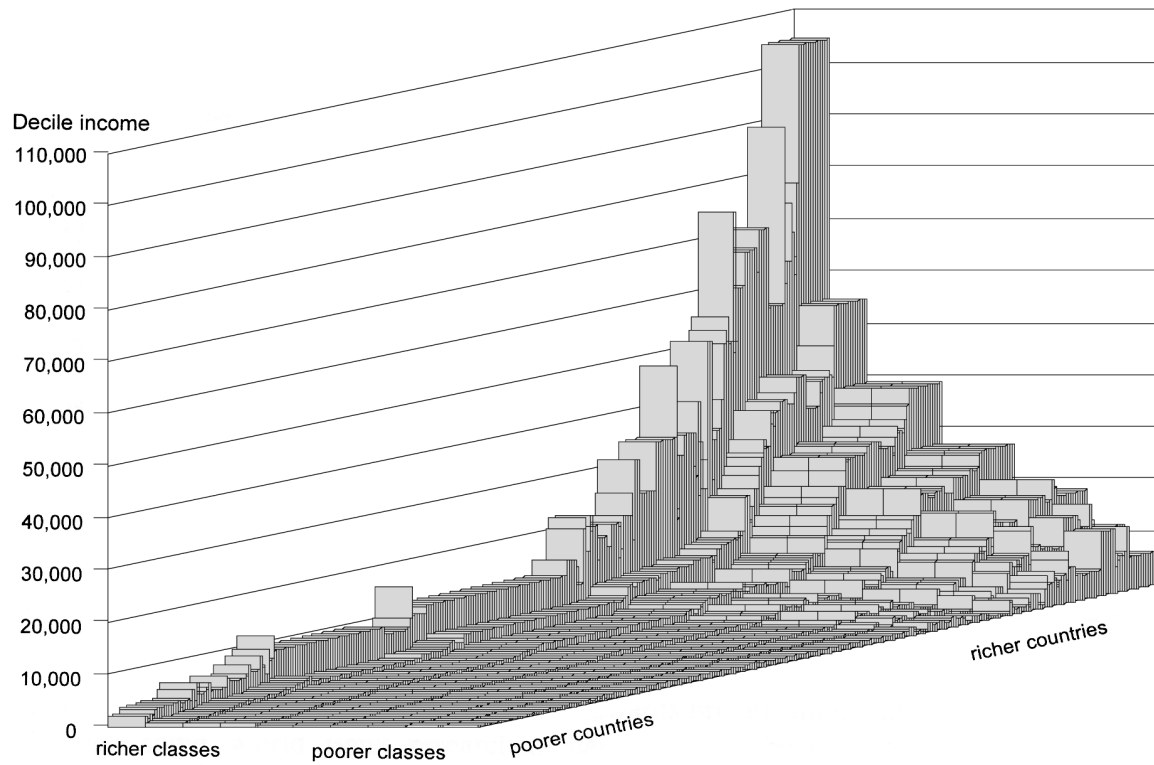
Another important factor has been the trend towards privatization, particularly during the 1990s, although some World Bank researchers have recently

Figure 3. Per Capita GDP in the 20 Poorest and Richest Countries in 1960-1962 versus in 2000-2002



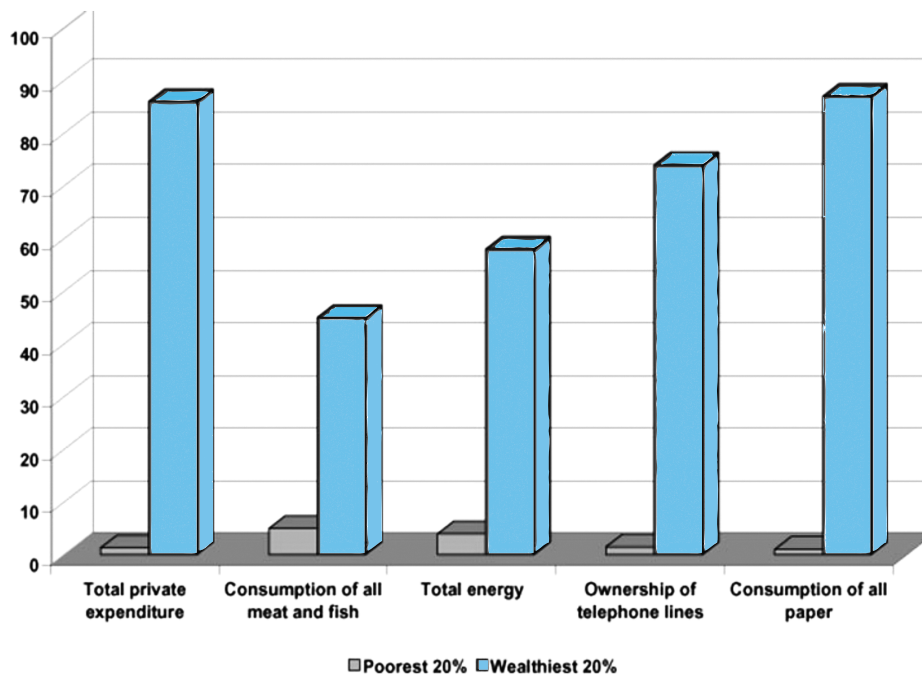
Source: Jomo and Baudot, *Flat World, Big Gaps: Economic Liberalization, Globalization, Poverty and Inequality*, 2007.

Figure 4. Global Income Distribution



Source: Jomo and Baudot, *Flat World, Big Gaps: Economic Liberalization, Globalization, Poverty and Inequality*, 2007.

Figure 5. Distribution of Global Private Consumption in the Poorest and Wealthiest Segments of World Population



Source: Jomo and Baudot, *Flat World, Big Gaps: Economic Liberalization, Globalization, Poverty and Inequality*, 2007.

been more critical of privatization. Strengthened intellectual property rights have also been important. The advent of stringent intellectual property rights internationally is of relatively recent origin, dating back to the second Reagan administration, when Secretary of State Schultz played a very important role in ensuring the enforcement of intellectual property rights by all “friendly countries.” Subsequently, this was incorporated as part of the Uruguay Round of trade negotiations, and then became a part of the World Trade Organization (WTO) framework, which is now fundamental in shaping the policy space which exists for developing countries.

GOVERNANCE

There is a great deal of rhetoric and concern about improving governance. What “good governance” implies is often subjective, even whimsical. As a number of statistical studies have pointed out, there has been no demonstrably rigorous relationship between good governance indicators and economic growth. The other factor is the changing nature of global economic governance in the Bretton Woods Institutions as well as the role of the new WTO. The WTO is not simply the new name for the General Agreement on Tariffs and Trade (GATT); it has created entirely new regimes of discipline on world trade, intellectual

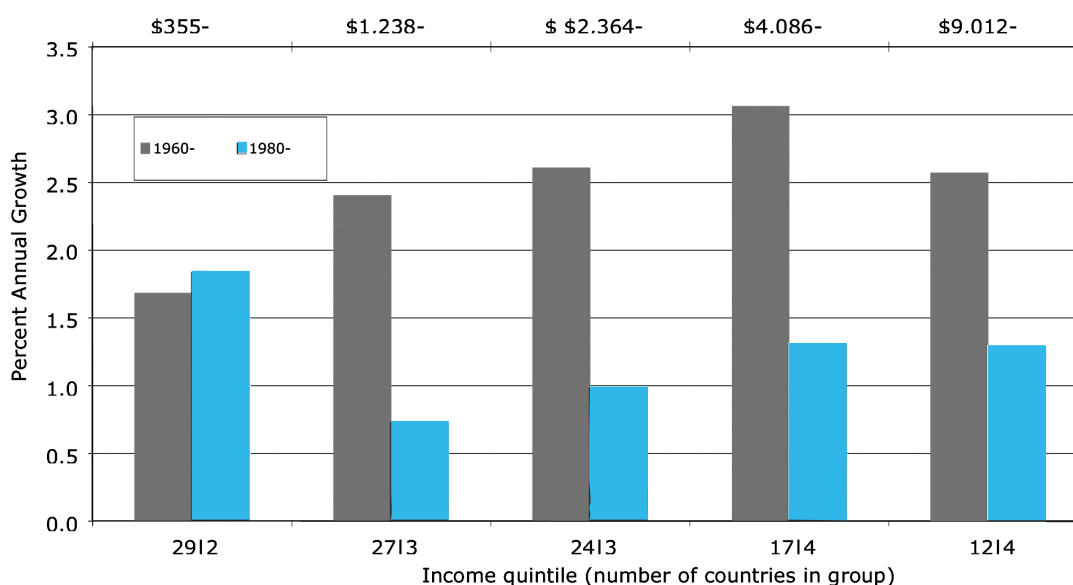
property rights, services, investments, and legal dispute resolution which have been extremely important in constraining policy space.

TRADE POLICY

Three areas are especially significant to a discussion of policy space constraints: trade, finance, and fiscal policies. In terms of the global trade regime, it is now generally accepted that the terms of trade have moved against developing countries in three ways. One is the relationship between primary commodities and manufactured goods. This was established in the United Nations half a century ago by Hans Singer and Raul Prebisch, the distinguished Argentine economist who became the first Secretary General of the United Nations Conference on Trade and Development (UNCTAD). Their findings have been supported by subsequent work, most significantly, the work of Grilli and Yang (1988).

Figure 6 demonstrates the downward trend in commodity prices over the course of the twentieth century. Historically, the sharpest decline in commodity prices occurred around 1920, and then again in the 1980s—after the oil and commodity price booms of the 1970s. There has been a decline in the terms of trade of tropical agricultural products in comparison to that of temperate agricultural product—a relationship

Figure 6. Average Annual Growth by Income Group, 1960-1980 versus 1980-2005



Source: Jomo with Baudot (2007); and Campos and Parra (2005).

which Arthur Lewis, the West Indian economist, drew attention to in the 1950s. Although comparable recent research has not occurred since the 1950s, trends for particular commodities suggest that the decline in the terms of trade for tropical agricultural products has continued. A good example is the price trend of cotton compared to that of wool.

The third and more recent development is the relationship between the prices of manufactured goods from developing countries compared to those from developed countries. Over the course of the last two decades of the twentieth century, there has been a decline in the prices of manufactures from developing countries compared to those from developed countries. There is no easy explanation for this. However, this trend might have something to do with the fact that developing countries generally start producing manufactured goods where there are no strong barriers to entry into those industries. These generic manufactures include textiles, ready-made garments, and so on. Strong intellectual property rights constitute monopolistic barriers to entry, enhancing market power in the hands of the corporations. Thus, the private sector is able to charge more—thus collecting rents—on the manufactures they produce and sell. There is little downward pressure through price competition. Thus, the terms of trade for manufactures from developing countries have declined compared to those from developed countries. The consequence of this is what Jagdish Bhagwati, a great advocate of trade liberalization, described more than 40 years ago as “immiserizing growth.”

Another salient factor is the importance of trade policy for industrialization. Due to the structural reforms and trade liberalization carried out over the last two decades, developing countries have experienced a significant collapse of manufacturing capacity. This has been largely associated with the demise of import-substituting industrialization, as many infant industries did not grow up to become internationally competitive. The region that has experienced this collapse of manufacturing capacity most severely is Sub-Saharan Africa. Many African countries attained independence after Asian and Latin American countries. African countries thus had much less time to develop their industries—and as a result their manufacturing and commodity industries were disproportionately vulnerable when trade liberalization was imposed on them.


Export-oriented industrialization has in comparison been more successful. However, many export-oriented

industries based on preferential market access have also collapsed when subject to the forces of trade liberalization. Until 2005 the Multi-Fibre Arrangement (MFA) used to provide opportunities for late-comer developing countries to begin industrialization through garments and textile production, traditionally a stepping stone in the industrialization process. When the MFA was phased out, the global economy witnessed the loss of millions of jobs in the garment manufacturing sector, a sector with a predominantly female workforce. This is one example of the impact of trade liberalization on women, and specifically on the ability of women in developing countries to attain economic and job security. The loss of jobs is also evident in part of the electronics industry in certain parts of the developing world that are no longer competitive with the advent of China as the most cost-competitive location for the manufacturing of consumer products.

The judicious use of trade policy has been crucial for development. In Northeast Asia during the post-World War II period, as in many other parts of the world before that period, effective conditional protection on export promotion was instrumental to spurring industrialization. Northeast Asian countries protected their domestic industries and firms from full international trade competition, on condition that they export their goods within a relatively short period of time. Requiring their domestic firms to export ensured that their industries became cost-competitive as well as quality-competitive, in order for their products to achieve acceptability and demand in foreign markets. Such devices, only possible through the strategic use of trade policy, were critical for developing countries in Northeast Asia to industrialize and develop economically.

The basis for the successful industrialization process in industrial and trade policies was anticipated and expanded on by Friedrich List. The contrast between his two books, *The Principles of the Natural Economy* and *The Principles of the National Economy*, is explained by his discovery of the work of Alexander Hamilton in the United States after his first book was published, and is an enlightening fact to consider. Hamilton's second work provides the basis for the strategy of contemporary import-substitution industrialization (ISI), which involves active industrial policies, selectively imposed barriers to trade, and sometimes, monetary policy that maintains undervalued domestic currencies. List recognized Hamilton's contribution to the understanding of the significance of

...There has been a critical shift in the international debate on financial liberalization in recent years, particularly following the Asian financial crisis of 1997-98.



trade protection for industrialization and development. In the second half of the 19th century, as the United States recognized its technological backwardness in comparison to England, trade protection became an integral part of the American effort to advance national technology and industry. Thus, the significance of the policy space that comes with strategic trade policy cannot be underestimated.

THE IMPLICATIONS OF AID FOR TRADE

The discussions on Aid for Trade may provide financial support and technical assistance to some developing countries for adjusting to trade reform and integration. The current discourse recognizes some adverse consequences of trade policy for developing countries. In terms of fiscal space, the Aid for Trade discourse recognizes that developing countries pursuing trade liberalization have lost a great deal of tariff revenue. For developing countries with very limited taxation capacity the loss of tariff revenue is extremely important. In some of the poorest countries, tariff revenue accounts for almost half of the total government revenue. Thus, reducing tariff revenue directly implies a tremendous reduction in fiscal space by directly shrinking the revenue that a state has access to.

The loss of production and export capacities is another grave consequence of trade liberalization. The very difficult task and cost of building new internationally competitive and productive capacities and capabilities for export is also beginning to be recognized by the Aid for Trade discourse. Whether or not Aid for Trade programs will actually match these various sizable costs and losses remains to be seen. Thus far, the indications are that Aid for Trade may simply divert existing aid, as some of it is specifically channeled and earmarked for such purposes.

INTERNATIONAL FINANCIAL LIBERALIZATION

In the area of finance, there has been a critical shift in the international debate on financial liberalization in recent years, particularly following the Asian financial crisis of 1997–98. The advocates of international financial liberalization, or financial globalization, used to argue that opening up barriers between countries would generate flows of funds from the capital-rich countries to the capital-poor countries. However, this claim has not materialized. In fact, what has occurred is a flow of funds in the opposite direction. As Ken

Rogoff, who used to be the economic counselor for the IMF, commented at the United Nations in November 2006, the United States now has the single largest foreign aid program, as a recipient. This is not without significance, as the flow of funds is originating from the developing countries, even from relatively poor continents—such as Africa—to the developed countries, rather than the converse.

Additionally, the cost of funds has not decreased, contrary to claims. There have been exceptional periods when the U.S. interest rate was very low, but generally speaking, the cost of money has not been cheap. While many of the old sources of volatility and instability have undoubtedly been reduced—as it is now possible to hedge against exchange rate or interest rate risks—new sources of volatility and instability have been introduced by the proliferation of financial instruments associated with “financial deepening.”

Other effects of financial liberalization, which constrain fiscal space, include the following. First, developing countries confront an increase in financial pressures, especially on finance ministers, to adopt monetary policies that are counter-inflationary. These counter-inflationary policies often have a deflationary effect on economic growth. Second, financial liberalization often leads to an undermining of institutions and instruments that have a developmental purpose—the demise of national development banks in many countries, for example. Third, with the state and its institutions being much more subject to market forces, the ability of central banks and finance ministries to adopt and develop counter-cyclical instruments and institutions has also been constrained. Thus, the ability to respond to pressures in financial markets or commodity price collapses, for example, has become much more challenging for the majority of developing countries. The 2006 Nobel Peace Prize to Mohammed Yunus of the Grameen Bank in Bangladesh recognized an important initiative to try to develop what might be termed “inclusive finance,” which involves making available credit facilities to low-income groups who would not otherwise have access to credit. Such endeavors to make access to credit possible for all levels of society are significantly constrained by financial liberalization. Overall, trade and financial instruments have been a central part of the development path in much of the world. Other factors include human resource and skills development and policies promoting technology and innovation.

MACROECONOMIC POLICY

Macroeconomic policy is far more pro-cyclical today than in previous times. This trend reflects the volatility of financial markets and commodity prices. The ability of developing nations to stimulate and stabilize growth, and to reduce global inequality at large, requires a much greater emphasis on policy space for counter-cyclical macroeconomics. The objectives of macroeconomic policy should take a broader view of macroeconomic stability. There is a tendency in recent discussions to focus on only one aspect of macroeconomic policy: consumer price stabilization. This is reflected in the skewed priority placed by the international community on inflation targetting, for example. In contrast to the focus on a narrow set of macroeconomic indicators, a broader and more developmental view would emphasize the need for macroeconomic stability in order to generate investments, growth, and employment in a much more mutually reinforcing manner. This view of macroeconomic policy would also avoid large economic swings, which developing countries tend to be much more vulnerable to, as well as gross external imbalances and financial crises.

The conventional approach to one of the most crucial aspects of policy space, that of fiscal space, is the view that increases in public expenditures should be undertaken without impairing the ability to service debt. This is particularly true with regards to developing countries that are heavily indebted to international creditors. This definition and approach tends to be biased against the imperative to promote growth and employment as fiscal policy objectives. The use of fiscal policy to offset cyclical downturns is often eschewed because it will ostensibly curtail government solvency. The counter-argument is that growth creates fiscal solvency, and not vice versa.

Recent OECD experiences challenge the conventional claim that government solvency and macroeconomic stability are preconditions for long-term growth, a relationship that is often presumed but does not stand up to critical scrutiny. Counter-cyclical fiscal policy should contribute to government solvency and to sustaining the mobilization of domestic resources. What constitutes good fiscal policy? The conventional approach tends to reject adopted fiscal targets based on current fiscal balances including expenditures, particularly structural current balances. The counter-argument is that a careful approach dif-

ferentiates between capital and current account expenditures, and this would constitute not only good accounting policy, but also sound macroeconomic policy. Thus, fiscal and trade policies are crucial for growth and structural change.

Current fiscal policy emphasizes maintaining government solvency and consumer price stability at the expense of promoting the expansion of domestic demand. The recent emphasis on fiscal solvency and macroeconomic stability has thus been detrimental to local growth in developing countries. In order to expand and strengthen fiscal space for development, developing countries should shoulder more responsibility for their own national development through more effective national resource mobilization. Developing countries should be less subject to the pressures of international tax competition, as there has been intense competition among countries to reduce tax rates in order to attract investors. Achieving development goals necessitates medium-term expenditure planning, and thus, medium-term commitments to financing, including more stable and predictable aid. Unfortunately, most development aid today is project-based aid rather than aid channeled through national budgets.

CONCLUSION

The World Bank adopted a number of structural adjustment programs in the 1980s and 1990s which were subjected to international criticism as the programs were increasingly found to have failed to alleviate poverty in developing countries. Since the late 1990s, the World Bank has switched to what are now called poverty reduction strategies. However, at the 2005 Summit, the international community advocated national development strategies. If the poverty reduction strategy papers of the World Bank are to genuinely address poverty, employment generation needs to be included and prioritized in these strategies. However, less than a quarter of the World Bank's poverty reduction papers include a serious commitment to employment generation, and 80 percent of the poverty reduction strategy papers for Sub-Saharan Africa do not incorporate any clause on employment generation. In addition, the Millennium Development Goals (MDGs) of the United Nations do not recognize employment generation as strongly as it should. This was corrected by the 2005 Summit which reiterated international commitments to the

internationally agreed development goals associated with United Nations summits and conferences since the 1990s, including the MDGs, but not confined entirely to them. Thus, the crucial question of employment generation has taken center stage in national development strategies, which are also emphasizing the issues of national ownership and policy space as means of achieving the MDGs and national development goals.

In 2005, both the *Report on the World Social Situation* as well as the *World Economic and Social Survey* discussed the questions of inequality and divergences. The World Bank came out with *Development in the 1990s* in 2005 as well, a report that was self-critical of the World Bank's role in adversely affecting development prospects in much of the developing world. This World Bank publication validated the critique that "one size does not fit all," and recognized the assertion that policy space is crucial for successful national development strategies. The United Nations' *Policy Notes* project provides an analysis of development policies different from the World Bank's PRSP policies—in the areas

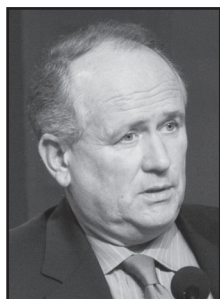
of macroeconomic policies, finance, state-owned enterprise reform, trade, investment and technology policy, as well as social policy.

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MACROECONOMIC POLICY SPACE AND THE GLOBAL IMBALANCES

HEINER FLASSBECK



THE CHALLENGE FOR DEVELOPING COUNTRIES

The ongoing process of globalisation is changing the framework of national macroeconomic policy, offering new opportunities, challenges and constraints for developed and developing countries alike. However, for many developing countries and economies in transition, integration into the globalizing economy has not been a smooth exercise. Many countries with fully open borders to international trade and private capital flows have experienced crises over the last quarter of a century that were triggered by instability and turmoil in the international financial markets and were characterized by the loss of control over domestic policy due to external constraints. This loss of policy space has triggered a debate on the available tool kit of national governments in macroeconomics as well as in other areas of economic policy.¹

The deregulation of domestic financial markets—including the elimination of credit controls, the deregulation of interest rates and the privatization of banks—was a key element of the global economic reform agenda in the 1980s and 1990s. It was firmly based on the belief that lifting “financial repression” and freeing prices on the capital and money markets would improve the inter-temporal resource allocation, enhance the willingness to save and attract additional resources to the banking system. Combining this with a liberalized capital account, the rationale was that developing countries would be able to attract financial savings leading to more capital rich economies, thus overcoming a major barrier to economic growth.

Consequently, the liberalization of international trade and finance in developing countries during the 1980s and 1990s was carried out under the heading

of “getting the prices right.” At the same time, however, a clear concept of how the most important international price, the exchange rate, and the closely related interest rate, should be determined or regulated was lacking. Having learned the hard way that reliance on supposedly benign capital inflows rarely results in a sustainable development strategy, a growing number of developing countries have shifted to an alternative approach that relies on trade surpluses as one of their principal engines for investment and growth. It is only through the approach of trade surplus generation that developing countries have had the national policy space to use their policy instruments effectively.

Most of the countries affected by the storm of the financial crises in Asia and in Latin America decided to use low valuations of their currencies and the swing from current account deficit to surplus to unilaterally fix their exchange rate or—at a minimum—to frequently intervene in the currency market to avoid the rapid return of their currencies to pre-crisis levels. The most striking example is China, where the national authorities—following the traumatic experience of an overvaluation and a large devaluation of the renminbi in 1994—absolutely fixed the value of the renminbi against the dollar.

However, the strategy to maintain trade surpluses by defending the competitive positions that were achieved in the wake of financial crises presupposes that at least one country in the global economy accepts to run the corresponding trade deficit. Other developing countries and transition economies have used the windfall profits of rising revenues for oil and other primary commodities to improve their balance of payments positions as well as to bolster their foreign exchange reserves. For many of these countries, interventions in the currency markets were intended to stem a strong concomitant rise of the real value of their currencies and to avoid a kind of “Dutch disease,” where the loss of competitiveness in manufac-

For policy-makers in developing countries... the role of exchange rate movements in the overall competitiveness of their economy is a very salient issue for national growth.

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turing is induced by trade surpluses and/or the net inflows of capital, which have the potential to appreciate the value of their currency.

The accumulation of foreign exchange reserves in developing countries results from their current account surpluses and currency market interventions to avoid exchange rate appreciation of their currencies. This has led to a situation in which developing countries have become net exporters of capital. The ability of many developing countries to reach the status of being a capital exporter has powerfully contested mainstream economic thinking, as it is in stark contrast to the expectation of orthodox macroeconomic theory that poor economies with a low capital endowment will have to import capital from countries that have an abundant endowment of capital.

For policy makers in developing countries, however, the role of exchange rate movements in the overall competitiveness of their economy is a very salient issue for national growth, security and development. The exchange rate in developing countries impacts the trade performance of the vast majority of local firms and is a crucial variable for national control over the balance of payments. Indeed, avoiding currency overvaluation is not only a means to preserve or improve macroeconomic competitiveness, but also an insurance against the risk of future financial crises. In this view, the current account surpluses of most of the developing world and the unwillingness of the developed world to consider a multilateral solution for the exchange rate system—including the obligations of developed countries to stabilize the exchange rate system in a way comparable to the Bretton Woods Institutions—places the burden of adjustment on the shoulders of the rich surplus countries of Japan and Germany as well as on some oil exporting countries. Unfortunately, there appears to be a significant theoretical rift among policy makers and experts on the right theory of global macroeconomic imbalances, let alone on the specific policies to correct them.

THE BIG RIFT IN FINANCIAL AND MACRO-ECONOMIC POLICIES

Indeed, general explanations for current account balances are difficult to find. Considering the theoretical positions of different schools of thought, there is no consensus whether current account disequilibria should be approached principally through trade flows

or from capital flows. This is indeed a crucial decision for policy considerations. The argument to address current account imbalances through trade flows stresses the fact that by definition the current account describes the difference between current receipts and expenditures for internationally traded goods and services and income payments. On the other hand, the capital flows view focuses on the fact that from a national perspective, the current account balance by definition always exactly equals the gap between national savings and domestic investments. Although it should be clear from the outset that this tautological relationship does not provide, by itself, any explanation or imply a certain causality, it is normally taken as the starting point for analysis and policy prescriptions.

According to the latter perspective of capital flows the decision to save a high share of disposable income leads to a current account surplus and a capital account deficit—in other words, net capital outflows—as not all of the savings can be put to productive use domestically. In the capital flows argument, the occurrence of an opposite outcome—a current account deficit or a net capital account inflow—is the result of the domestic propensity to invest being in excess of the national propensity to save. Trade and current account balances are then basically the result of the voluntary decisions of national agents to consume now or at a later stage. Consequently, it is not expected that national current accounts will be balanced. Rather, in a world of liberalized financial markets, savings should always flow toward their best use at the global level.

Through the arbitrage of capital flowing from excess-saving countries toward countries with greater opportunities for profitable investments, the global economy achieves a more efficient allocation of resources and higher growth rates than would be possible without the free mobility of capital. However, the theoretically assumed outcomes of financial liberalization do not find sufficient empirical support even in the “consensus evidence.” Prasad, Rogoff, Wei, and Kose (2003) sum up the existing literature and assess that “...an objective reading of the result of the vast research effort undertaken to date suggests that there is no strong, robust, and uniform support for the theoretical argument that financial globalization per se delivers a higher rate of economic growth...[and] the volatility of consumption growth has, on average, increased for emerging market economies in the 1990s.”²

The main theoretical problem with this view is its inherent tautological nature and its inability to explain the outcomes of the conflicting preferences of national households or national governments at the global scale. In other words, this approach, despite being well founded in microeconomic decision making, cannot explain how the autonomous decisions of private households of n countries in the world to save more than to invest leads to the necessary result that only $n-1$ countries will succeed in generating a current account surplus while one country, although also willing to achieve a current account surplus, finds itself possessing a huge deficit. In other words, the fallacy of composition systematically excludes an unprejudiced, truly voluntary decision of all participating players. Moreover, the approach has to rely extensively on an assumption of “all things being equal,” as it does not systematically consider the effects that changes in the saving decisions of one sector or one agent may have on the savings of the company sector whose income is the residual of the market process.

The trade-based explanation of macroeconomic imbalances is more substantive in its main message as it does not just describe movements of imports and exports as result of voluntary decisions of economic agents, but also points out the shocks in trade flows induced by large unforeseen changes in the relative prices between tradable and non-tradable goods and services as well as in the international competitiveness of countries. For example, the trade-based explanation stresses commodity price fluctuations to provide an explanation for two occurrences: the current account swings of producers of key commodities like oil, and the exchange rate exceeding the fundamental determinants of overall competitiveness. In this view, the decision of private households to save less does not affect the trade balance as long as the additional demand can be satisfied by competitive domestic production. The decline in the private household savings rate can also be compensated by increases in saving of other agents: initially through business profits, and consequently by higher government savings or higher tax levels. Thus, in the trade-based approach to macroeconomic imbalances, the relationship between national savings and the trade balance is much more complex than in the capital account approach, as it involves decisions by all the relevant agents in a society and all agents in other countries including policymakers.

In the latter view, the global benign outcome is owed primarily to the pragmatism of macroeconomic policy management in the United States. As the U.S. authorities have not attempted to fight the quickly rising current account deficits early on, the systemic deficiencies in the global economic order have not led to global deflation yet. However, it has led to a very serious global imbalance. However, even with U.S. macroeconomic policy pragmatism, the resulting global pattern of production, trade and finance has become increasingly precarious. It seems that sooner or later the United States will become overburdened by playing the role of the global growth engine and that of the creditor of last resort. The U.S. could largely ignore its external imbalance as no serious conflict with sustaining full employment domestically has occurred up to this point. However, if the U.S. economy slows down, such a conflict may soon become a significant risk. But even without a major slowdown in the U.S. economy the world economy will have to manage without the growth stimuli from the U.S. economy, which the world economy has become used to over the past fifteen years.

THE SUSTAINABILITY OF THE U.S. EXTERNAL IMBALANCE

International concerns about the sustainability of the United States increasing external imbalance are increasing among financial market analysts, as it is a significant and imminent risk. Slow progress in the unwinding of the imbalances may trigger a strong speculative wave towards dollar depreciation, which could subsequently generate a downwards pressure on other major global currencies. Such a depreciation of the dollar would help re-balance the United States economy. However, given the pattern of global growth—and the dependence that global growth has on American demand in consumption and imports—a marked slowdown in exports to the US would have global deflationary repercussions. This could quite easily unravel the momentum in development progress and poverty reduction seen in developing countries in recent times without any fault of their own.

The main reason for the United States perhaps increasingly unmanageable global burden is not the rising number of developing countries running current account surpluses, rather, it is primarily the fact that other key industrial countries have failed to play

For small open economies, and developing countries in particular, the exchange rate is the most important single price.

their corresponding international role in stimulating global demand. Even worse, they have decisively added to the global burden of the United States by improving their overall competitiveness at the expense of other countries through deflationary macroeconomic policies and real depreciation of their currencies. Japan and Germany are two countries in particular that are now being called upon to live up to their global responsibility by reversing their past economic trends. The required competitiveness gains of the U.S. economy should come predominantly at their expense. This would compensate for the gains in competitiveness that these countries have achieved over the past few years.

China can also play a crucial role in the benign unwinding of global imbalances, albeit in a different way. Since the beginning of the 1990s China's domestic demand and its imports have grown very strongly, and the country has been a vital actor in spreading and sustaining the growth momentum throughout the developing world. This is a process which must not be derailed. Therefore, renminbi revaluation should continue gradually rather than abruptly, taking into careful account the regional implications. More recently, oil exporting countries have also acquired a significant position in addressing the global macroeconomic imbalances. Oil producers should use favourable terms-of-trade practices to increase and promote productive investments and accelerate the diversification of their production and manufacturing sectors. Should elevated oil prices persist, oil producers have the potential to contribute to the correction of global imbalances through creating stronger domestic demand and import growth in line with higher incomes.

THE CASE FOR A MULTILATERAL EFFORT TO MANAGE EXCHANGE RATES

For small open economies, and developing countries in particular, the exchange rate is the most important single price, as it has a strong impact on the domestic price level and on overall competitiveness. It must be flexible enough to prevent persistent misalignments that would harm the competitiveness of domestic producers and their trade performance. At the same time, excessive volatility of the exchange rate must be avoided, as this would heighten the risks for long-term investment, increase domestic inflation, and encourage financial speculation.

The “corner solutions” are based on two distinct assumptions. The first assumption is that in the case of free-floating exchange rates, international financial markets will smoothly adjust exchange rates to their “equilibrium” level. The second assumption is that in the case of a hard peg, product, financial, and labor markets will always smoothly and rapidly adjust to a new equilibrium at the predetermined exchange rate. In reality however, exchange rates under a floating regime have proved to be highly unstable, leading to long spells of misalignment with dire consequences for the real economic activity of the economies involved. The experience with hard pegs has not been satisfactory either. As the exchange rate cannot be corrected in cases of external shocks or misalignment, adjustments are expensive in terms of lost output, which affects the real sectors of the domestic economy the hardest.

Given this experience with both rigidly fixed and freely floating exchange rates, “intermediate” regimes have become the preferred option in most developing countries with open capital markets. Intermediate regimes provide more room for manoeuvre when there is an instability in international financial markets. They also enable adjustment of the real exchange rate to a level that better supports a country's development strategy. None of the “corner solutions” offer these possibilities.

For developing countries that are not members of a regional monetary arrangement that enables them to cope with the vagaries of the global financial markets, they resort to capital controls on short-term capital flows or strictly follow a strategy of undervaluation and unilateral fixing.³ In the words of Martin Wolf, “By accident the world has found a way to make the crisis-prone world of financial globalization work.”⁴ This strategy—based on national policy space and control over the relevant monetary instruments such as the exchange rate and the interest rate—can only be replaced by a multilateral effort or multilateral surveillance if the rich developed economies are willing to play a more proactive role in the steering of the international monetary system. This would include directly intervening in the international monetary system to enable orderly currency depreciations for countries in monetary and financial trouble. Past experience has demonstrated that developing countries with strong current account positions are able to avoid destabilizing capital inflows and outflows, either by taxing those flows or by limiting

their impact through directly intervening in both local and global capital and financial markets. In these cases the hardest choices and the gravest misallocations due to erratic exchange rate changes have been avoided. However, neither the resort to capital controls nor to permanent intervention can be a substitute for an appropriate exchange rate system at the regional or—preferably—the global level.

A long run solution for the international financial system has to commence with the observation that the exchange rate of any country is—by definition—a multilateral phenomenon, and that any change in the exchange rate of open economies produces externalities and multilateral repercussions. That is why the idea of a cooperative global monetary system is as compelling as the idea of a multilateral trading system. In the same way that multilateral trade rules design a global trading system, the global financial system has to create equal conditions to all parties involved and help avoid unfair competition. Indeed, most of the ideas on which the International Monetary Fund was founded more than 60 years ago are still valid—including the idea of supra-national money replacing the U.S. dollar as the global medium of exchange. Avoiding competitive depreciations and other monetary distortions that have negative effects on the functioning of the international trading system are more important in today's highly interdependent world than at any other time in history.

In a well-designed global monetary system the advantages of exchange rate changes in one currency need to be balanced against the disadvantages incurred to other affected countries. As changes in the nominal exchange rate deviating from the fundamentals in terms of inflation differentials affect international trade in exactly the same way as changes in tar-

iffs and export bounties do, such real exchange rate changes have to be subject to multilateral oversight and negotiations. Reasons for the deviation from the fundamentals and the necessary dimension of the deviation need to be identified by an international institution and should be enforced by a multilateral decision-making body. If such rules apply, the real exchange rate of all the parties involved—including their overall competitiveness—will have to remain constant, despite permanent structural changes and huge variations in competitiveness on the level of the private sector.

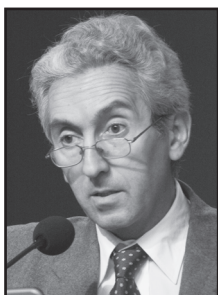
ENDNOTES

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CONSTRAINING POLICY SPACE IN INTELLECTUAL PROPERTY

CARLOS M. CORREA

Intellectual property rights (IPRs) may affect developing countries' capabilities to educate their people, produce and compete domestically and globally, as well as to provide essential health services.



THE ARGUMENTS ON INTELLECTUAL PROPERTY RIGHTS

Intellectual property protection creates exclusionary rights that limit the access to and the use of a vast array of intellectual works, technologies, and products needed for social and economic development in developing countries. Intellectual property rights (IPRs) may affect developing countries' capabilities to educate their people, produce and compete domestically and globally, as well as to provide essential health services.

Given the overarching influence of IPR systems on national interests, it would seem logical to incorporate sufficient flexibilities for developing countries to design the systems of intellectual property rights in a manner that is consistent with their development needs. The forms and levels of IPR protection should correspond to the characteristics of different countries' innovation systems, taking into account people's income and needs.

Each country and each sector is affected in different ways by IPRs. Welfare economics examines the impact of intellectual property rights on economic efficiency.

There are two main types of efficiency:

- Static efficiency is achieved when there is an optimal use of existing resources at the lowest possible cost.
- Dynamic efficiency is the optimal introduction of new or better products, more efficient production processes and organization, and (eventually) lower prices.

In general, static efficiency is best achieved through competitive markets. In terms of consumer welfare, competition may lead to allocative efficiency when the price of a product is equal to the marginal

cost of producing a unit of it. In this scenario there is a maximum diffusion of existing products. When the products are essential for life—as with food and pharmaceuticals—allocative efficiency becomes an important objective on both economic and equity grounds.

The static-dynamic efficiency rationale applicable to a developed society does not necessarily have a rationale when strong inequalities exist. High levels of IPRs protection may have significant negative allocative consequences in developing countries, without contributing—or even impeding—their social and economic development. For instance, consumers in developing countries contribute to the research and development (R&D) budgets of pharmaceutical companies. Such companies, however, tend to concentrate, for the most part, on research projects that lead to drugs that address the needs of the rich, neglecting those drugs required for the majoritively low-income populations and health epidemics—such as malaria, for example—in developing countries. In addition, since IPRs create a monopoly over information or the expression thereof, the exclusive rights on information can collide with certain fundamental social needs and/or individual rights, such as the right to education and health and the right to freedom of expression.

IPRs have a powerful potential to promote innovation and creativity, as the very nature of knowledge—as a public good—makes it particularly difficult to stop free-riders from enjoying a third party's works or innovations without paying for them. The predominant argument supporting the establishment of strong IPRs is that they are required for preserving the ability of the creator or producer of knowledge to obtain an economic reward. Without the presence of economic rewards, there may be little or no incentive to provide public goods privately, leading to the supply of some public goods becoming scarce.

However, several refutations can be made on this argument. First, competition in the absence of IPRs can lead to dynamic efficiencies as it may be a pow-

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erful incentive to introduce product, process, or organizational innovations. Many important innovations are the result of stiff competition, particularly when different technological options may be pursued. One well known example is the case of the industry for semiconductors, where IPRs play a marginal role as an incentive for innovation. Many studies also indicate that patent protection is not always, or even usually, the driving force behind R&D. In the area of software, non-appropriation mechanisms, such as open source schemes, have proven to promote a vibrant process of innovation. Second, protection from imitation may result from several non-IPRs mechanisms, such as lead time, the innovator's capacity to move on the learning curve before other competitors, the customer loyalty derived from superior sales and services, and from the very structure of the market, such as in the case of oligopolistic market structures. Third, the exclusionary rights conferred by IPRs can lead to the underutilization of information, especially for the generation of subsequent innovation. Cumulative forms of innovation prevail in most sectors of the economy, including the biomedical field. Since information is both an *output* and an *input* in its production process, a conflict arises between first and second generation innovators, because the greater the rights (and hence incentives) of the first generation, the greater the costs (and hence the lower the incentives) of the second generation producers. Finally, a significant part of innovation takes place as a result of routine production activities and learning, completely unrelated to the existence and scope of IPRs protection.

James Boyle, in his article on the World Intellectual Property Organization (WIPO) and the future of intellectual property, has noted that:

Intellectual property policy is in the sway of a maximalist "rights-culture" which leads debates astray. The assumption seems to be that to promote intellectual property is automatically to promote innovation and, in that process, the more rights the better. But both assumptions are categorically false. Even where intellectual property rights *are* the best way to promote innovation, and there are many areas where they are not, it is only by having rules that set the correct *balance* between the public domain and the realm of private property that we will get the innovation we desire.

But genius is actually *less* likely to flower in this world, with its regulations, its pervasive surveillance, its privatized public domain and its taxes on knowledge. Even if the system worked exactly as specified, it could not solve some of the most important human problems we face, and it would likely hamper our most important communications technology.¹

A HISTORICAL ASSESSMENT

In contrast to the current trends towards the expansion and strengthening of IPRs, when today's industrialized countries were in their process of development, they enjoyed a great deal of flexibility to design their IPR systems. Mark Twain's personal struggle to have his copyright recognized internationally provides an example of the lack of IPR rules at that time. Twain even tried to register his name as a trademark in order to avoid the free copying of his novels. Twain's literary works, as well as those of other British authors, were pirated in the U.S. during much of the 19th century. Foreign authors did not receive copyright protection until 1891. Charles Dickens toured the USA in 1842 pleading for international copyright. He published the *American Notes* in 1843, where he expressed his frustration with the lack of copyright law in the United States. Fifty thousand pirated copies were sold in only three days within the U.S. During that period, *A Christmas Carol* by Charles Dickens sold for the equivalent of \$2.50 in London, whereas in the U.S. it sold for merely six cents a copy.²

The arguments articulated during that period in the United States against international copyright laws have a strong parallel to the situation many low-income developing countries are in today, where dozens of students chase the only available copy of an educational book. At that time in the 19th century, the U.S. argued four key points. First, expanding literacy demanded cheap yet high-quality books. Second, there was no inherent property rights in literature. Third, granting copyrights to foreigners would give them a monopoly at the expense of the U.S. reading public. Finally, local publishers in the U.S. and their employees are in need of the *de facto* advantage afforded by the absence of protection.³

In the case of patents, the United States—as a net importer of technology between 1790 and 1836—prioritized the issuing of patents to its own citizens and residents. In 1836, patent fees for foreigners were

fixed at ten times the rate for U.S. citizens, exhibiting a robust protection for and promotion of local knowledge and products over that of the foreign. European countries such as France, Germany, and Switzerland, while being avid proponents of strong patent protection today, only recognized pharmaceutical product patents after the 1960s. Similarly, Portugal, Spain and the Nordic countries did not recognize pharmaceutical patents until the end of 20th century. Furthermore, the most successful cases in recent history of industrial and technological development, in such countries as Japan and South Korea, occurred under a flexible framework of IPR protection. The development of the Indian pharmaceutical industry, which has become a major world supplier of cheap generic medicines and active ingredients, was also possible in the absence of pharmaceutical product patents.⁴

THE TRADE RELATED ASPECTS OF INTELLECTUAL PROPERTY RIGHTS AGREEMENT

Such a flexible scenario, however, has changed dramatically with the adoption of the Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement of the World Trade Organization (WTO). This Agreement is essentially the outcome of a well-organized campaign of a few industries, notably in the pharmaceutical, entertainment, software, and semiconductors sectors. Under the TRIPS rules much of the flexibility that developed countries enjoyed to design their IPR systems is not permitted to developing countries. Although many arguments regarding increased technology transfers, foreign direct investment (FDI) to, and innovation in developing countries were made during the negotiations by the proponents of the TRIPS Agreement, the Agreement itself is quite clearly intended to benefit the industrialized countries and industries who already have a greater capacity to generate new knowledge and information.

An early study by Phillip McCalman concluded that:

Patent harmonization has the capacity to generate large transfers of income between countries, with the United States being the major beneficiary...These transfers significantly alter the perceived distribution of benefits from the Uruguay Round, with the U.S. benefits sub-

stantially enhanced, while those of developing countries and Canada considerably diminished. Furthermore, accounting for the increase in dead weight loss from higher standards of patent protection undermines the aggregate benefits of the Uruguay Round package, with the increase in dead weight loss amounting to as much as one fifth of the efficiency gains from trade liberalization.⁵

McCalman's findings have been amply confirmed by recent statistics. Although there is no conclusive evidence of an increase in the flows of production technologies to developing countries, there has been an impressive rise in global royalty payments, which grew from 61 billion dollars in 1998 to 120 billion in 2004, the United States being the main beneficiary thereof.⁶

Unlike other WTO agreements, the TRIPS Agreement does not include a Special and Differential Treatment (SDT) for developing countries. The absence of SDT also applies to Least Developed Countries (LDCs)—the poorest countries in the world—whose markets are too small and thus largely irrelevant for transnational companies (TNCs). However, LDCs have been permitted to delay their compliance with TRIPS obligations and rules until July 2013.⁷

According to Article 66.2 of the TRIPS Agreement, developed Member countries are obliged to provide incentives under their national legislation to enterprises and institutions in their territories for the purpose of promoting and encouraging the transfer of technology to LDCs “in order to enable them to create a sound and viable technological base.”⁸ It has been unclear how this obligation is to be effectively implemented. Interestingly, this provision is premised on the concept that the implementation of intellectual property protection, as required by the Agreement, is not conducive to the technological development of LDCs and that more flexibility is needed. This is precisely the argument that developing countries have articulated, during the TRIPS negotiations and that have thereafter reiterated in different fora, such in the context of the “Development Agenda” submitted by a group of developing countries to the World Intellectual Property Organization. The main argument of this proposal is:

A vision that promotes the absolute benefits of intellectual property protection without acknowledging public policy concerns undermines the very credibility of the IP system.

The Declaration recognized the “gravity” of the public health problems afflicting many developing countries—and LDCs in particular.

Integrating the development dimension into the IP system... will strengthen the credibility of the IP system and encourage its wider acceptance as an important tool for the promotion of innovation, creativity and development.⁹

The constraints imposed by the TRIPS Agreement have been highly debated, particularly on the subject of patents for pharmaceuticals. The Agreement imposed a number of detailed obligations on patent creation, application, and distribution with the aim to construct a global patent regime (see Table 1).

The concerns about the implications of patents for access to drugs have also been voiced by developing countries and NGOs in various forums, particularly due to the impact of patents on the prices of essential medicines and the proliferation of patents of low or non-existing inventive steps that are aggressively used to restrain legitimate generic competition. These concerns on the access to medicines were eventually brought to international attention, and subsequently reflected in the Doha

Ministerial Declaration on TRIPS and Public Health, or the Doha Declaration on TRIPS. The Declaration recognized the “gravity” of the public health problems afflicting many developing countries—and LDCs in particular—from HIV/AIDS, tuberculosis, malaria, and several other epidemics.¹¹ It confirmed some of the flexibilities incorporated into the TRIPS Agreement, such as the possibility of granting compulsory licenses and of permitting the parallel importation of patented products. A key paragraph in the Declaration stated that:

We agree that the TRIPS Agreement does not and should not prevent WTO Members from taking measures to protect public health. Accordingly, while reiterating our commitment to the TRIPS Agreement, we affirm that the Agreement can and should be interpreted and implemented in a manner supportive of WTO Members’ right to protect public health and, in particular, to promote access to medicines for all (paragraph 4).

The quest for equitable global development is not benefiting from, and is indeed being seriously harmed, by a global IPR regime.

Table 1. TRIPS Obligations Regarding Patent Protection¹⁰

<ul style="list-style-type: none"> • Patents shall be granted for any inventions, whether products and processes, provided they are new, involve an inventive step and are capable of industrial application. 	<p>in the art to carry out the invention. The indication of the best mode of carrying out the invention, as well as information concerning corresponding patent applications and grants, may be required.</p>
<ul style="list-style-type: none"> • Patents shall be granted in all fields of technology, including pharmaceuticals. No discrimination is allowed with respect to the place of the invention, or based on whether the products are locally produced or imported. 	<ul style="list-style-type: none"> • Limited exceptions to the exclusive rights can be defined by national laws (article 30).
<ul style="list-style-type: none"> • Member countries can exclude from patentability diagnostic, therapeutic and surgical methods for treatment of humans or animals, as well as plants and animals and essentially biological processes for the production thereof. 	<ul style="list-style-type: none"> • Conditions for granting other uses without the authorization of the patent holder (compulsory licenses) are set forth; Member countries can determine the grounds to allow such uses.
<ul style="list-style-type: none"> • Exclusive rights conferred in the case of product and process patents are defined, subject in the case of imports to the principle of exhaustion (article 6). 	<ul style="list-style-type: none"> • Revocation/forfeiture is subject to judicial review.
<ul style="list-style-type: none"> • Inventions shall be disclosed in a manner which is sufficiently clear and complete for a skilled person 	<ul style="list-style-type: none"> • The term of protection shall be at least twenty years from the date of application.
	<ul style="list-style-type: none"> • Reversal of the burden of proof in civil proceedings relating to infringement of process patents is to be established in certain cases.

BILATERAL AND REGIONAL FREE TRADE AGREEMENTS

While the adoption of the Doha Declaration on TRIPS seemed to address the pressing concerns of developing countries, the U.S. simultaneously initiated a series of negotiations on bilateral and regional free trade agreements (FTAs) with more than twenty countries. Bilateral and regional FTAs incorporate what is commonly termed as “TRIPS-plus” requirements—essentially, IPR rules and commitments that go beyond that of TRIPS. FTA agreements were produced between the U.S. and a various countries globally: Jordan, Chile, Singapore, Morocco, the Central American countries and the Dominican Republic, Bahrain, Oman, Peru, and Colombia. Some of them have already been ratified by the US Congress.¹² Other FTAs have been signed by or under negotiation between developing countries and the European Union or the European Free Trade Association.

The common pattern of the ensuing FTAs is that they further elevate the level of protection conferred virtually in all areas of IPR, most notably copyright and patents. In the latter case, partner countries are obliged, inter-alia, to grant patents on plants, extend the patent term in certain circumstances, and adopt the “utility” standard for patentability (in substitution of the narrower requirement of industrial applicability). They are also obliged to grant exclusive rights in respect of test data regarding pharmaceuticals and agrochemicals. In some cases, the protection enforceable under the FTAs with the U.S. is significantly higher than that applicable in the U.S. itself.¹³ Paradoxically, FTAs do not seem to generate the same scale of obligations in the U.S., thus leading to a critically skewed situation where U.S. companies will receive more extensive and deeper IPR protection in FTA signatory countries, including many poor LDCs, than the same companies will receive in the United States itself.

There is no justification—legal or economic—for this augmented limitation to the already narrow national policy space that countries had retained on IPRs after the TRIPS Agreement was first produced. There is an urgent need to thoroughly review the implications of these developments, particularly for the poor. The IPR agenda, today under the control of a small but extremely powerful coalition of business interests, needs to be placed under public accountability. The quest for equitable global devel-

opment is not benefiting from, and is indeed being seriously harmed, by a global IPR regime that may lead to a dangerous stifling of knowledge-creation, technology transfer, innovation, and access to medicines. Such a situation will only perpetuate poverty and injustice in vast parts of the low- and middle-income developing world that will fundamentally deteriorate the quest for equitable and sustainable global development.

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POLICY SPACE AND THE GENDERED IMPACTS OF INTERNATIONAL FINANCIAL INSTITUTIONS

ELAINE ZUCKERMAN



For over a quarter of a century, the international financial institutions (IFIs) have been constraining country sovereignty and national policy space—the ability of a country to have options and flexibilities in designing national policies.¹ This protracted process has exacerbated

poverty in the world's poorest countries, instead of reducing it, despite IFI claims to the contrary. This paper first discusses IFI policy space occupation, and second, its gendered impacts, which are illustrated by country-level case studies.

...IFI-mandated tariff reductions undermine the livelihood of farmers, the majority of whom are women in the world's poorest countries.

THE POLICY SPACE OCCUPATION OF IFI CONDITIONALITIES

This section illustrates IFI policy space occupation through examining “conditionalities” and debt cancellation and reduction.

Conditionalities

Since 1980, the primary vehicle that IFIs have used to squeeze borrowing governments' policy space is the “conditionalities” attached to IFI Structural Adjustment Loans (SALs) and projects. SALs are an early name for policy-based loans that IFIs have used to impose conditionalities on developing and transition countries.² Besides financing policy-based loans that significantly restrict policy space, the World Bank and other Multilateral Development Banks (MDBs) also use project loans to impose conditionalities on economic policies.³ Agricultural, rural development, water supply, sanitation, education, health and virtually every type of conventional IFI project imposes conditionalities such as requiring developing countries to privatize services and drop tariffs unilaterally without developed country reciprocity. Increasingly

popular non-project-specific sector-wide loans also inflict IFI conditionalities that squeeze country policy space.

Over time, IFIs have responded to persistent civil society and citizen complaints, including popular street protests, which have vociferously criticized IFI policy conditionalities for their harmful social and gendered impacts. IFI responses include avoiding using the names “SALs” and “conditionalities” and claiming that conditionalities have been eliminated.⁴ IFIs have actually increased the number of conditionalities through bundling several conditionalities into one, and renaming them, for example by calling them benchmarks.

DEBT CANCELLATION AND REDUCTION

Another recent IFI policy space issue that has attracted significant press coverage is the cancellation and/or reduction by IFIs of poor countries' debts. Many civil society organizations (CSOs) applaud an increasing series of IFI debt cancellations, as unconditional debt cancellation can free up policy space, permitting countries to choose policies that advance human development instead of spending their national revenues to repay IFI debts. Debt relief can release otherwise debt-locked public resources for spending on education, health, and other critical development programs.

Two types of IFI debt cancellation are being discussed: those initiated by countries themselves and those resulting from debt cancellation or reduction by the IFIs and other creditors. First, regarding debt cancellation initiated by countries themselves, Gender Action and many civil society partners celebrate that a cascade of countries have been paying off their debts to the International Monetary Fund (IMF), and announcing an end to their ties to the IMF. Since 2003, some of the IMF's largest debtor countries have decided to pay off their IMF debts ahead of schedule. These countries include Argentina, Brazil, Colombia, Indonesia, Serbia and

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Uruguay. For example, in 2006 Brazil paid its total debt of \$15.5 billion, Argentina its debt of \$9.5 billion, and Uruguay its debt of 1.08 billion to the IMF. Ecuador has vowed to repay, or restructure, its IMF debt of \$10.28 billion.⁵ These Latin American countries have found unconditional alternative financing from oil-rich Venezuela. Several of these countries announced that they no longer want, or need, IMF control over their policy space due to the sharply negative impacts of IMF loan conditionality on their national growth and development processes.

These debt cancellations have placed the IMF in a legitimacy, relevancy and budget crisis. The IMF is searching for a new mandate and for ways to survive.⁶ IMF supporters, particularly the Group of Eight countries (G-8), are attempting to reinvent the IMF by creating new IMF programs. Taking advantage of the timing of the IMF crisis, hundreds of CSOs around the world have launched a campaign in 2006 titled “The IMF: Shrink or Sink It!”⁷ The involved CSOs believe that the IMF needs comprehensive reform at the least, and if that fails, it should close. The campaign aims to eliminate the IMF’s “gatekeeper” function: its powerful role as head of an aid cartel. Without the IMF’s “green light,” or signaling power, endorsing a government’s policies, most multilateral and bilateral donors and creditors, as well as the private sector, withdraw aid to that government. Policies comprising the IMF’s overarching market-driven development strategy occupy national policy space. These policies—imposed as conditionalities—call for deregulation, privatization and public spending reductions, among other economic reforms. In many African countries, these conditionalities have resulted in annual per capita incomes falling by over 50 percent in the last two decades.

Anti-IMF campaign recommendations involve the following points: First, to refuse to sign new loan agreements or enter into new programs with the IMF. Second, to conduct citizen, parliamentary, and other government audits of IMF performance and impacts. The campaign popularizes the option of withdrawing from the IMF altogether. Citizen pressure has led to the poorest countries receiving IFI debt cancellation, in order to relieve low-income countries that are burdened by illegitimate IFI debt. In 2005 the G-8 countries decided to cancel African Development Bank, World Bank, and IMF debts of 18 Highly Indebted Poor Countries (HIPC) countries. In early 2007, the Inter-American Development Bank cancelled debts

amounting to US\$6.5 billion out of a total of US\$15 billion that five Latin American countries owed the bank. To become eligible for debt relief, countries must comply with IFI-imposed policy reforms, further giving up policy space.

To date, only one country, Bolivia, among the poor countries receiving debt relief, has publicly announced its intention to break with IMF policies. Another low-income country, Ghana, announced that it would not renew its Poverty Reduction Growth Facility (PRGF) agreement with the IMF upon its imminent expiration. Following up could open Ghana’s nationally-owned policy space to determine the design of its economic and social policies, for example, on revenue-raising and social sector spending priorities. Most countries want and deserve to regain sovereign control of their policy space and resources, instead of spending their resources on massive debt repayments to IFI creditors. However, countries receiving debt relief need to be on guard of attempts by the IMF, World Bank, and other IFIs to impose new conditionalities through new arrangements. Debt-relieved countries must carefully retain their ability to determine national economic policies, even after debt relief is implemented.

GENDERED IMPACTS

This section discusses the gendered impacts of IFI policy conditionalities through examining poverty reduction strategies and operations and several country cases. Framed by the above picture of IFIs squeezing national policy space and sovereignty, Gender Action’s starting point is that the 70 percent of the world’s poor who are women bear a disproportionate amount of the burdens of IFI economic reform conditionalities. IFI loan conditionalities to poor developing countries not only impinge on country-level sovereignty by requiring governments to comply with their creditors notions of how to reform economic, financial and trade policies, but they also contribute to the feminization of poverty. Not only have over a trillion dollars of IFI development loans not reduced poverty, rather the loans have in many instances deepened poverty, especially among women.⁸ For example, IFI-mandated tariff reductions undermine the livelihood of farmers, the majority of whom are women in the world’s poorest countries. In Africa, most of the 80 percent of farmers who are women have experienced income drops due to conditionalities such as required tariff reductions.

Until recently, Gender Action monitored Poverty Reduction Strategy Papers (PRSPs) for the gender impacts of economic policies contained within the programs. Both the IMF and World Bank require that low-income country governments prepare national development plans called “PRSPs.” PRSPs are a prerequisite for accessing virtually all development aid. Although the IMF and World Bank constantly state that PRSPs are country-owned, PRSPs must meet World Bank and IMF specifications and obtain Fund and Bank Board approval. Gender Action found that PRSPs address gender issues unsystematically. Since realizing that PRSPs policies are not enforceable, Gender Action stopped engaging in PRSPs, shifting attention to Poverty Reduction Growth Facilities (PRGFs) and Poverty Reduction Support Credits (PRSCs), described below, because they contain enforceable conditionalities. PRSPs are aspirational in comparison. Gender Action also continues to focus on mandatory IFI sector project loan conditionalities—for example conditionalities requiring countries to privatize services and/or adopt user fees in post-conflict reconstruction, health, education, agriculture and other sector loans.

In 1999 the IMF renamed its macroeconomic stabilization loans for the poorest countries, known as Enhanced Structural Adjustment Facilities, to Poverty Reduction Growth Facility (PRGF) Arrangements. The World Bank renamed some of its SALs Poverty Reduction Support Credits (PRSCs). These name changes were intended to announce a greater emphasis on poverty reduction. Despite their rhetoric about reducing poverty, macroeconomic policies in PRSPs, PRSCs and PRGF Arrangements continue two decades of IMF and World Bank conditionalities that prioritize decreasing government spending and increasing government revenue to repay debts owed to the IFIs and other creditors over reducing poverty. Ironically, the World Bank’s new Gender Action Plan committed the Bank to address gender issues in policy-based loans.⁹ However, the World Bank’s paramount Operational Policy on Gender and Development waives policy-based loans from its requirement that all Bank loans promote gender equality.¹⁰

GENDERED IMPACTS IN COUNTRY-LEVEL CASES

The following country-level cases illustrate the foregoing discussion of the gendered impacts of IFI-mandated policy reforms.

Democratic Republic of the Congo

The Democratic Republic of the Congo (DRC) provides an example of IFI loans that guarantee corporate investments in mine privatization and restructuring with tragic incomes for women. The gender dimension is missing in IFI policy discussions governing mining loan conditionalities and revenues. The major beneficiaries of IFI mining operations are transnational corporations and local elites who turn a blind eye to harmful gendered outcomes that include forced household displacements, sexual slavery and mass rape.

For example, the World Bank Group’s Multilateral International Guarantee Agency provides political risk insurance to private mining companies operating in the DRC; the World Bank Group’s International Development Association makes loans to the DRC to “restructure” the mining sector including laying off tens of thousands of workers.¹¹ These reinforcing policy conditionalities affect the economic livelihoods of women and girls who are involved in labor and services attached to dangerous mining activities, sometimes involving children as young as seven years old. Their livelihoods are also undermined by the environmental destruction caused by mining. These environmental effects require local women in surrounding communities to have to walk even farther to find firewood—an endeavor that increases their exposure to rape and other forms of violence. Households, and particularly the women and girls in them, face a daunting array of needs for physical safety. IFI loans do not address these gendered outcomes of their loan operations.

Malawi

For years, the Bank and Fund have been forcing Malawi to privatize ADMARC—the state marketing board—and the Strategic Grain Reserve (SGR), which used to keep the price of maize affordable. Privatization of ADMARC and the SGR has contributed to a food crisis in Malawi.¹² Women, forced to wait into the night in long lines at ADMARC to buy maize, risk attack on their way home from the queue. When women cannot afford to buy maize, women must scavenge for leaves and boil tubers and roots to feed themselves and their families.

Chronic hunger has also forced desperate rural Malawian women and girls into sex work and early marriage, and increased their exposure to HIV/AIDS. The excess supply of sex workers has glutted the market; sex workers claim that prior to the food crisis they could charge US\$8 for unprotected sex and

US\$1–2 for sex with a condom. Since the food crisis, rates have sharply plummeted to US\$0.80 without a condom. Workers would rather die a little later from AIDS than die from hunger today.

Mozambique

Mozambique's successive IMF PRGF and World Bank PRSCs—the policy-based loans described above—mandated a new labor law which increases labor flexibility in five ways. One, retrenchment costs are reduced, including severance pay. Two, wages are paid in the form of piece-rates rather than fixed wages based on hours worked. Three, company-led downsizing and the use of short-term labor is facilitated. Four, hiring practices become contractual rather than secured through long-term employment contracts; and, five, employing foreign nationals is made easier. It is unexpected for a country that has maintained an average per capita income growth rate of about ten percent for a decade to be as impoverished as Mozambique is, with extraordinarily high rates of illiteracy and HIV/AIDs, especially among females. Although Mozambique did endure a deep civil war, it has achieved a postwar decade of high-rate growth. This anomaly exists because a handful of transnational corporations (TNCs) owns a few large capital-intensive and export-oriented projects that employ only a small percentage of Mozambique's total population and enrich only a minority elite and the TNCs. IFI policies and loans that support TNCs and elites, rather than the poor, have deepened poverty in Mozambique especially among women who compose the majority of the poor, the illiterate, and the ill.

Serbia and Montenegro

Serbia and Montenegro are now two independent republics but when Gender Action reviewed their World Bank policy-based loans in 2004, the two republics were united. In Serbia and Montenegro, World Bank and IMF structural adjustment loans (SALs) formed the primary response to a devastating decade of civil war. After Serbia and Montenegro rejoined the World Bank in 2001, at least 80 percent of initial Bank operations were SALs. This high proportion of adjustment operations characterizes economic reforms in transition countries more broadly. Gender Action's analysis shows how Serbia and Montenegro's SALs fail to acknowledge or mitigate the harmful impacts on men and women.¹³ Here are a couple of examples:

- In Serbia and Montenegro, women comprise the majority of service sector workers providing finance, education, and health services, and the majority of textile industry employees. The World Bank Private and Financial Sector Adjustment Credit required the governments to privatize the textile industry and smaller enterprises and downsize the public sector including finance, health, and education without regard for the gender impacts. Women's precarious economic position in these enterprises and government jobs made them especially vulnerable to lay-offs. They constituted the majority of the unemployed and informal sector employees with few assets to become self-employed.
- The World Bank Serbia Social Sector Structural Adjustment Credit reforms pension, labor, and employment laws. It encourages self-employment but fails to acknowledge the barriers that prevent women from succeeding in small businesses. It diminishes protection from discrimination for women and other workers in weak positions in the labor market. For example, women lack the collateral to access loans since men own most of the property. Serbia's new labor law eliminates previously required collective bargaining and weakens labor's power. Women now comprise a larger percentage of the unemployed. Women have been hurt most by the Bank policy conditions.

Tanzania

Tanzania has borrowed over US\$5.8 billion for 45 operations from the African Development Bank, the International Monetary Fund, and the World Bank since the year 2000. At least half of these operations, comprising over a quarter of loan funds, appear to be loans containing potentially harmful components.

For example, World Bank projects in Tanzania include the following:

- A Secondary Education Development Program approved in 2004 for \$150 million, and includes resettlement, administrative decentralization, decreasing costs per pupil, and increasing class sizes.
- The Primary Education Development Program approved in 2001 for \$150 million imposes double-shift teaching on 50% of primary schools, increasing student enrollment but limiting instruction time per student.

Women's precarious economic position in these enterprises and government jobs made them especially vulnerable to lay-offs.

- The World Bank's Second Health Sector Development Project approved in 2003 for \$65 million introduces user fees.
- The Bank's Dar es Salaam Water Supply and Sanitation Project approved in 2003 for \$62 million includes retrenchment of workers, price increases, and resettlement of unauthorized water users. Women who already comprise the vast majority of poor Tanzanians are hardest hit by these conditionalities.

In another operation, to comply with World Bank and IMF loan requirements, the Tanzanian government sold the management of the Dar es Salaam Urban Water and Sewerage Authority (DAWASA) to City Water, a joint venture between private companies based in Germany, Britain and Tanzania.¹⁴ After City Water took over in 2003, tariffs increased. Although women were primarily responsible for fetching water in Tanzania, an Action Aid report found that the City Water privatization scheme utterly neglected to consider household gender relations or the needs of women and girls in the reform. The primary benefits of high water prices were reaped by the corporation, City Water, and owners of private water wells while poor women and girls continued to have to walk often long distances to carry water without remuneration. Women and girls who could not walk long distances for affordable water were forced to spend the majority of their household income on water instead of much-needed food supplies and education. Bowing to public complaints, in 2005 the government of Tanzania was forced to cancel its contract with City Water.

CONCLUSIONS

The burdens on women in accessing essential services, such as water, show how basic human needs remain unfulfilled in Africa. How is it that the IFIs, despite the billions of dollars they have allocated to water supply and transportation projects in Africa, hardly succeed in relieving poor women and girls from having to carry water on their heads barefoot on unpaved roads? First-hand testimonies by African women have revealed that carrying water for hours every day significantly diminishes the amount of time that they have for income-generating work. As the Tanzanian example above illustrates, IFI investments

in privatizing water monopolies increases poverty and corporate profits. The programs and loans of the IFIs have diminished or eliminated opportunities of women and young girls to earn income and attend school, respectively.

Why are such IFI policy conditionalities so persistent and so sticky? Why do the IFIs do everything to camouflage the continuation of conditionalities? Our case examples demonstrate that a key reason is that IFI conditionalities open up developing country markets to profitable TNC investments. In IFI loans the main beneficiaries have been the TNCs that win IFI contracts and local elites, not the poor whom the IFIs claim are the beneficiaries. If the poor were the beneficiaries of the \$100 billion that IFIs disburse annually, there would be much less poverty in this world.

In 1989, the World Bank had a task force that laid the groundwork for the 1990 World Development Report on poverty.¹⁵ The task force concluded that reducing poverty requires asset and income redistribution. Asset ownership has become more concentrated and income distribution gaps have widened in most countries since the late 1980s. IFI policies and loans that cater to TNCs and elites, not the poor whom they claim to serve, help explain why poverty and income distribution have worsened.

ENDNOTES

1. That the Woodrow Wilson International Center for Scholars first invited me to present in 1987 and again almost 20 years later on this topic underscores the long intractability of IFI occupation of poor countries' policy space.
2. For a description of the many names IFIs use for policy-based loans since launching SALs, see Vladislavjevic, Aleksandra and Elaine Zuckerman, "Structural Adjustment's Gendered Impacts: The Case of Serbia and Montenegro," Gender Action, 2004, <http://www.genderaction.org/images/Gender-SALs-Serbia&Mont.PDF>.
3. All IFIs support both SALs or policy-based loans as well as investment projects except the IMF that only makes loans for the former.
4. Vladislavjevic, Aleksandra and Elaine Zuckerman, "Structural Adjustment's Gendered Impacts: The Case of Serbia and Montenegro."
5. Manuela Badawy, "Venezuela: A Financing Center for Latin America-Fitch," Reuters, February 6, 2007, <http://www.veninfo.org/news/02-06-07reu.html>.
6. The International Monetary Fund, "Eminent Persons Group Outlines Long-Term Revenue Plan to Finance IMF Activities," IMF Press Release No. 07/18, January 31, 2007, <http://www.imf.org/external/np/sec/pr/2007/pr0718.htm>; and "Funding the Fund: Putting

- the IMF's own house in order," *The Economist*. February 3, 2007.
7. Gender Action is a founding member of the first concerted anti-IMF campaign that citizens' groups launched during the September 2006 annual World Bank-IMF meetings. See the initial campaign document, "The IMF: Shrink it or Sink it: A Consensus Declaration," July 2006, <http://www.genderaction.org>.
 8. Suzanna Dennis and Elaine Zuckerman, "Gender Guide to World Bank and IMF Policy-Based Lending," Gender Action and the Heinrich Boell Foundation, December 2006, <http://www.genderaction.org/publications.html>.
 9. The World Bank Group, "Gender Equality as Smart Economics: A World Bank Group Gender Action Plan (Fiscal years 2007–10)," September 2006, <http://siteresources.worldbank.org/INTGENDER/Resources/GAPNov2.pdf>.
 10. World Bank mandatory Operational Policies have precedence over action plans.
 11. For example, the World Bank Group's Multilateral International Guarantee Agency provides political risk insurance to private mining companies operating in the DRC: <http://www.cao-ombudsman.org/html-english/DemocraticRepublicofCongo.htm>; the World Bank Group's International Development Association makes loans to the DRC to "restructure" the mining sector, including laying off 10,000 workers; information on this is available at: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/AFR/2004/12/15/8793B0DBCBC1CC6585256F030017596D/1_0/Rendered/PDF/38150DRC1CONFORMED.pdf and http://www.bicusa.org/Legacy/DRCWorldBank_August_2003.pdf.
 12. Suzanna Dennis and Elaine Zuckerman, "Gender Guide to World Bank and IMF Policy-Based Lending."
 13. Ibid.
 14. Ibid.
 15. The World Development Report, the World Bank's annual flagship publication, highlights a different theme each year and is available at <http://www.worldbank.org/wdr>.

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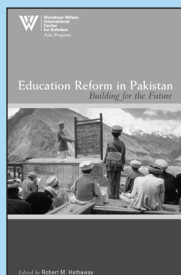
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