

Making Trade Fair

If any trade agreement were to be a success, it should have been the one among Mexico, the United States, and Canada. Enacted in 1994, the North American Free Trade Agreement (NAFTA) created what was at the time the largest free trade area in the world, with 376 million people and a GDP of nearly \$9 trillion.¹ The pact opened up the world's richest country, the United States, to Mexico. These two countries had a shared—though not always pleasant—history. Mexican immigration to the United States has been large; vast parts of the United States are Spanish-speaking; and the United States relies on Mexican labor in areas such as agriculture, manufacturing, and unskilled services. Some 10 million Mexicans—a tenth of Mexico's population—are living, legally or illegally, in the United States.² As Mexicans come to the United States to work, many stay, marry American citizens, raise their children, and now even dominate communities in states like California, Texas, and Arizona. Even before NAFTA, Mexico and Canada were America's biggest trading partners, as well as the countries most visited by U.S. citizens.

The ties between the two countries, combined with the disparity in economic and political power, bring tensions. As the Mexican saying goes, "Mexico—so far from God, so close to the United States." America's per capita income is six times that of Mexico. The corresponding

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sixfold wage difference, together with Mexico's high unemployment rates, exerts an enormous pull across the border, with thousands risking their lives to enter illegally. It is not in the United States' interests to have a poor, unstable country on its southern border, and NAFTA supporters hoped the pact would bring Mexico's economy forward and help this country, rich with art and history and culture, prosper. Instead, more than ten years later, it is clear that NAFTA has not succeeded. While it has not been the disaster that its critics predicted, neither has it brought all the benefits that were claimed by its advocates.

Advocates of trade liberalization believe it will bring unprecedented prosperity. They want developed countries to open themselves up to exports from developing countries, liberalize their markets, take away man-made barriers to the flows of goods and services, and let globalization work its wonders. But trade liberalization is also among the most controversial aspects of globalization; many see the alleged costs—lower wages, growing unemployment, loss of national sovereignty—as outweighing the purported benefits of greater efficiency and increased growth.

In part, free trade has not worked because we have not tried it: trade agreements of the past have been neither free nor fair. They have been asymmetric, opening up markets in the developing countries to goods from the advanced industrial countries without full reciprocity. A host of subtle but effective trade barriers has been kept in place. This asymmetric globalization has put developing countries at a disadvantage. It has left them worse off than they would be with a truly free and fair trade regime.

But even if trade agreements had been truly free and fair, not all countries would have benefited—or at least benefited much—and not all people, even in the countries that did benefit, would share in the gains. Even if trade barriers are brought down symmetrically, not everyone is equally in a position to take advantage of the new opportunities. It is easy for those in the advanced industrial countries to seize the opportunities that the opening up of markets in the developing countries affords—and they do so quickly. But there are many impediments facing those in the developing world. There is often a lack of

infrastructure to bring their goods to market, and it may take years for the goods they produce to meet the standards demanded by the advanced industrial countries. These are among the reasons that when, in February 2001, Europe unilaterally opened up its markets to the poorest countries of the world, almost no new trade followed. To fulfill the promise that more trade will follow from trade liberalization, much else is required, as we shall see.

Moreover, trade liberalization exposes countries to more risk, and developing countries (and their workers) are less prepared to bear that risk. Workers in the United States and Europe worry about being thrown out of their jobs as a result of a surge in imports. But workers in these countries have a strong safety net to fall back on: they have the education that makes it easier to move from one job to another; they often have bank accounts and receive severance pay to buffer their transition between jobs. Workers in developing countries have none of these.

Finally, even if trade does follow, not everyone is a winner. The theory of trade liberalization (under the assumption of perfect markets, and under the hypothesis that the liberalization is fair) only promises that the country as a whole will benefit. Theory predicts that there will be losers. In principle, the winners could compensate the losers; in practice, this almost never happens. If all the benefits go to a few at the top, then trade liberalization leads to rich countries with poor people, and even those in the middle may suffer. Thus, if liberalization is not managed well, the majority of citizens may be worse off—and see no reason to support it. It is not a matter of special interests opposing liberalization, but of citizens correctly perceiving the world as it is.

But this is not the world as it has to be. Trade liberalization can, when done fairly, when accompanied by the right measures and the right policies, help development. As we saw in chapters 1 and 2, the most successful developing countries in the world have achieved their success through trade—through exports. The question is: can the benefits that they enjoy be sustained, and be brought to all of the people of the world? I believe they can be; but if that is to be the case, trade liberalization will have to be managed in a way very different from that of the past.

The North American Free Trade Area

Understanding why NAFTA failed to live up to its promise can help us to understand the disappointments of trade liberalization. One of the main arguments for NAFTA was that it would help close the gap in income between Mexico and the United States, and thus reduce the pressure of illegal migration.³ Yet the disparity in income between the two countries actually grew in NAFTA's first decade—by more than 10 percent. Nor did NAFTA result in a rapid growth in Mexico's economy. Growth during that first decade was a bleak 1.8 percent on a real per capita basis, better than in much of the rest of Latin America but far worse than earlier in the century (in the quarter century from 1948 to 1973, Mexico grew at an average annual rate per capita of 3.2 percent).⁴ President Fox promised 7 percent growth when he took office in 2000; in fact, in real terms, growth during his term of office averaged only 1.6 percent per annum—and real growth per capita has been negligible. In fact, NAFTA made Mexico more dependent on the United States, which meant that when the U.S. economy did poorly, so did Mexico's.

Not only did NAFTA not lead to robust growth, it can even be argued that in some ways it contributed to Mexico's poverty. Poor Mexican corn farmers now have to compete in their own country with highly subsidized American corn (though the relatively better-off Mexican city dwellers benefit from lower corn prices). A fairer trade agreement would have eliminated America's agricultural subsidies and its restrictions on imports of agricultural goods, like sugar, into the United States. Even if the United States did not eliminate all its subsidies, Mexico should have been given the right to countervail—that is, to impose duties on US imports to offset the subsidies. But NAFTA does not allow that.

While NAFTA eliminated tariffs, it allowed a whole set of nontariff barriers to stand. After NAFTA was signed, the United States continued to use nontariff barriers to bar Mexican products that had begun to make inroads in its markets, including avocados, brooms, and tomatoes. When, for instance, Mexican tomato exports to the United States began to increase in 1996, Florida tomato growers pressured

Congress and the Clinton administration to take action. If Mexico could be shown to be selling tomatoes below cost, it could be charged with dumping, and anti-dumping duties could be imposed. But Mexico was not dumping tomatoes. The reason that Mexico could be charged with selling below cost was because prices were measured in a deliberately lopsided fashion (I will discuss this more fully later in the chapter). Mexico did not want to risk a trial, so agreed to raise its price. American consumers and Mexican tomato growers were hurt, but Florida tomato producers got what they wanted—less competition from Mexican tomatoes.

The one part of Mexico's economy that was successful, at least in the years immediately after NAFTA, was the area just south of the border. So-called maquiladora factories sprang up, supplying American manufacturers like General Motors and General Electric with low-cost parts. Employment grew 110 percent over NAFTA's first six years, compared with 78 percent over the previous six years.⁵ (Elsewhere, employment stagnated.)⁶ Advocates of NAFTA are quick to take credit for these successes, while arguing that the failures are not NAFTA's fault and that matters would have been far worse without the agreement. There is, of course, no easy answer to this sort of counterfactual argument, which supposes an imaginary alternative. But careful studies do shed some light. One can ask whether, given the expansion of the U.S. economy and the dramatic fall of real wages in Mexico after 1994 in comparison both to the United States and to its competitors in Asia, one would have expected an increase in Mexican exports to the United States comparable to what was observed. The answer, based on standard economic models, is yes. NAFTA seems to have added little, if anything.⁷

Equally telling is what happened after the first flush of NAFTA. After the early years of growth in the maquiladora region, employment there too actually started to decline, with some 200,000 jobs lost in the first two years of the new millennium.⁸ Some of the factors that had led to growth, like the strong U.S. economy, had waned. But there was a more fundamental problem. Not only was the United States growing faster than Mexico in the years after NAFTA, but so was China.⁹ Trade liberalization is important for growth, but not as important as NAFTA

supporters had hoped. NAFTA gave Mexico a slight advantage over other U.S. trading partners; but Mexico, with its low investment in education and technology, has had a hard time competing with China, which invests twice as much (as a percentage of GDP) in research. Countries often hope that trade agreements will boost foreign investment and create jobs. But when companies make investment decisions they look at many factors, including the quality of the workforce, infrastructure, location, and political and social stability.

Tariffs play only a limited role, as China's success makes clear. By focusing on tariffs, NAFTA diverted attention from other things that needed to be done to make Mexico competitive. Indeed, reduced tariffs have created their own problems. Prior to NAFTA, tariffs made up 7 percent of Mexico's tax revenue; after NAFTA, the figure dropped to 4 percent. Mexico's public expenditures of around 19 percent of GDP—more than a third financed by oil revenues—are markedly lower than those of Brazil or the United States, and are insufficient to finance needed public investment in education, research, and infrastructure.

TRADE LIBERALIZATION: THEORY AND PRACTICE

The British economist Adam Smith, the founder of modern economics, was a strong champion of both free markets and free trade, and his arguments are compelling: free trade allows countries to take advantage of their comparative advantage, with all nations benefiting as each one specializes in the areas in which it excels. Large trading areas allow firms and individuals to specialize further and become even better at what they do. Imagine a small village with only one baker, then consider that a larger village might have two or three. A bigger town would support a larger number of bakers, some of whom will make only bread and others who will make only cakes. An even bigger city will have not only bread makers and cake makers; its bakers will have so many customers that they can specialize even further, making a wide variety of very good cakes and gourmet breads. Bigger markets enhance the efficiency of each producer and the choice available to consumers.

Without free trade, capital and labor will earn different returns in

different countries (assuming capital and labor cannot move freely—which is a fair assumption, especially in the short run). In a country that lacks capital, such as machinery and technology, labor will be less productive and wages will be lower. If labor moves from a country where productivity and wages are low to one where they are high, the increase in output can be enormous, and the world's economy grows. Free trade is a substitute for people actually having to move. We can sit at home in the developed world and buy inexpensive goods from China, a country where labor is cheap. Conversely, the Chinese can stay in China and get high-tech goods from the United States, a country with more advanced technology, highly skilled labor, and large capital investment. In theory, this will mean that as the demand for Chinese goods increases, the demand for their unskilled labor increases, and eventually unskilled wages in China will be higher.¹⁰

The Fear of Job Loss

The downside to this rosy scenario is the possibility that jobs will be lost as they move from one country to another—for example, as people in the United States buy cheap goods made in China instead of in the United States. Free trade advocates say that although jobs are lost, new opportunities are created. High-productivity/high-wage jobs replace low-productivity/low-wage jobs. The argument is persuasive, except for one detail: in many countries, unemployment rates are high and those who lose their jobs do not move on to higher-wage alternatives but onto the unemployment rolls. This has happened especially in many developing countries around the world when they liberalized so fast that the private sector did not have time to respond and create new jobs, or when interest rates were so high that the private sector could not afford to make the investments necessary to create new jobs.

It even happens in developed countries, though there, if monetary and fiscal policies are working well, jobs should be created in tandem with jobs that are lost. But too often, that does not happen. Unemployment in Europe has remained stubbornly high. People who lose their jobs do not automatically get new jobs. Especially when the unemployment rate is high, there may be an extended period of unemployment as workers search for a new employer. Middle-aged workers often fail

to find any job at all—they simply retire earlier. Low-skilled workers are particularly likely to suffer. That is why people in the advanced industrial countries worry about losing manufacturing jobs to China or service sector jobs (like back offices of financial companies) to India. When the result of rapid trade liberalization is that unemployment goes up, then the promised benefits of liberalization are likely not to be realized.¹¹ When workers move from low-productivity, protected jobs into unemployment, it is poverty, not growth, that is likely to increase.¹²

Even if they do not actually lose their jobs, unskilled workers in advanced industrial countries see their wages decrease. They are told that unless they agree to lower wages, the reduction of benefits, and the weakening of job protections, competition will force the firm to move the jobs overseas. Young workers in France have been mystified by how the removal of long-fought-for job protections and the lowering of wages—necessary, it is alleged, to compete in the global marketplace—will make them better off. They are told to be patient, that in the long run they will see that they are better off; but, given the number of cases in which those promises have failed to be fulfilled ten or twenty years after liberalization, their skepticism is understandable. John Maynard Keynes, the great economist of the mid-twentieth century, had responded to those who urged patience in the midst of the Great Depression as markets would in the long run restore the economy to full employment, by saying yes, but “In the long run, we are all dead.”¹³

Politicians and economists who promise that trade liberalization will make everyone better off are being disingenuous. Economic theory (and historical experience) suggests the contrary: even if trade liberalization may make the country as a whole better off, it results in some groups being worse off.¹⁴ And it suggests that, at least in the advanced industrial countries, it is those at the bottom—unskilled workers—who will be hurt the most.¹⁵

The world of Adam Smith and the free trade advocates, in which free trade will make everyone better off, is not only a mythical world of perfectly working markets with no unemployment; it is also a world in which risk doesn't matter because there are perfect insurance markets to which risk can be shifted, and where competition is always perfect, with no Microsofts or Intels dominating the field. In such a world,

workers wouldn't worry about losing their jobs because of trade liberalization; they would move seamlessly into other jobs. Even if there was some glitch, workers could buy insurance against the risk of being temporarily unemployed, or against the risk that the new job paid less than the old. Even in the best-functioning market economies, this kind of insurance can't be bought; while in developed countries the government provides some unemployment insurance, in most developing countries workers are left to fend for themselves.

That is why trade liberalization requires more than just onetime assistance to move from the old industries to the new. More open economies may be subject to all manner of shocks—domestic firms, for instance, may find it hard to compete with an onslaught of imports that suddenly become cheaper when a foreign country devalues its currency, as in a crisis. When Korea's currency was devalued, Korean steel exports to the United States increased, and American steelworkers complained. When Brazil has a good orange crop, Florida orange growers cry for help, and sometimes get it through one of the nontariff protectionist mechanisms described below.¹⁶ Everyone feels the insecurity.

It is not just those who lose their jobs, and their families, who are affected. Almost everyone is at risk. For example, when local industries shut down because of competition from imports, their suppliers are adversely affected. Increased insecurity is one of the reasons that opposition to trade liberalization is so widespread.

But while globalization has led to more insecurity and contributed to the growing inequality in both developed and less developed countries, it has limited the ability of governments to respond. Not only does liberalization require removing tariffs, which are an important source of public revenue for less developed countries, but to compete a country may have to lower other taxes as well.¹⁷ As taxes are lowered, so are public revenues, forcing cuts in education and infrastructure and expenditures on safety nets such as unemployment insurance at a time when they are more important than ever, in order both to respond to the competition and to help people cope with the consequences of liberalization.

While developing countries may suffer from trade liberalization, they are not always in a position to reap its benefits through increased exports. There are several reasons for this: One already noted is that

they often lack the infrastructure (ports and roads) needed to move their products. The other is they may not have anything to export. Capital markets are highly imperfect, with interest rates in developing countries at a much higher level than those with which even the best of entrepreneurs in the developed world could cope; even if someone sees a new export opportunity he cannot get the necessary finance, at least at reasonable terms. These supply-side constraints are a big problem in many of the poorest countries of the world, such as in Africa. By now, there are numerous instances in which advanced industrial countries have opened up their markets, but the gains in exports have been limited. These countries will need some form of assistance—aid for trade—to help them take advantage of the new opportunities. Some used to argue that trade was more important than aid; trade helps a country to stand on its own. But it is better to see aid and trade as complements: both are needed for successful development.¹⁸

Infant Industries and Infant Economies

Countries often need time to develop, in order to compete with foreign companies; to get this time, they may have to protect their nascent industries temporarily. The standard argument for free trade is based on efficiency. More goods can be produced with given resources if each country focuses on its own comparative advantage. But even more important in determining the pace of growth in developing countries is how fast they acquire the knowledge and technology of the advanced industrial countries. We saw in the last chapter that developing countries not only lag in resources but also in technology; for achieving sustained growth, closing the knowledge gap is more vital than improving efficiency or increasing available capital. The question is: how best to learn? Some argue that the best way—probably the only way—to learn how to produce steel is to produce steel, as Korea did when it started a steel industry. At the time, its comparative advantage was growing rice. But even if Korean farmers became the most efficient rice producers in the world, their incomes would still be limited. The Korean government realized that if it was to succeed in becoming developed, it had to transform its economy from agriculture to industry.

If developing countries are to enter into such industries, those

industries have to be protected until they are strong enough to compete with established international giants. Tariffs result in higher prices—high enough that the new industries can cover costs, invest in research, and make the other investments that they need in order to be able eventually to stand on their own feet. This is called the “infant industry argument” for protection.¹⁹ It was a popular idea in Japan in the 1960s—and in the United States and Europe in the nineteenth century. Most successful countries did in fact develop behind protectionist barriers; critics of globalization accuse countries like Japan and the United States, which have climbed the ladder of development, of wanting to kick the ladder away so that others can't follow.

Advocates of free trade respond with two main criticisms of the infant industry argument. First, they say, the appropriate response is not protection; if in the long run the firm will be profitable, it can obtain a loan to tide it over the hard times. In the real world, however, new firms have a difficult time getting capital. The United States government has only partially overcome this problem by having a Small Business Administration (SBA) that provides loans for small businesses. (The U.S. shipping and logistics giant FedEx began with an SBA loan.) In developing countries, these problems are even more acute.

Second, critics argue that, too often, protected infants never grow up, and demand to be permanently insulated from outside competition. More generally, special interests grab hold of any argument, including the infant industry argument, to push protectionist measures in pursuit of higher profits—which impose enormous costs on the rest of the economy.²⁰ In Bangladesh, protection of textile producers puts apparel makers in jeopardy by raising the cost of raw materials. These experiences are a warning for any country contemplating using protection as a basis for encouraging new industries.

But the politics of different countries differ, and there is nothing inevitable in such a political failure. East Asia did manage to wean its infants; the question is whether others have political systems capable of doing the same.

One of the responses to the last criticism of the infant industry argument is to focus on broad-based protection, a uniform tariff on, say, manufactured goods. This is the approach of the infant economy (as

opposed to the infant industry) argument for protection.²¹ Without protection, a country whose static comparative advantage lies in, say, agriculture risks stagnation; its comparative advantage will remain in agriculture, with limited growth prospects. Broad-based industrial protection can lead to an increase in the size of the industrial sector, which is, almost everywhere, the source of innovation; many of these advances spill over into the rest of the economy, as do the benefits from the development of institutions, like financial markets, that accompany the growth of an industrial sector. Moreover, a large and growing industrial sector (and the tariffs on manufactured goods) provides revenues with which the government can fund education, infrastructure, and other ingredients necessary for broad-based growth. In chapter 4, we will see that advocates of strong intellectual property protections argue for exactly the same trade-off: they claim that the short-run inefficiencies (in that case, arising from monopoly; in this case, arising from tariff protection) are more than offset by long-run dynamic gains. In each case, it is a question of getting the balance right: almost surely, some intellectual property protection is desirable; and almost surely, some trade protection is desirable. While the economic rationale behind the infant economy argument is similar to that behind the infant industry argument, the political argument is far stronger: broad-based protection reduces the scope for special interest.

If advocates of the infant industry argument have sometimes been excessively optimistic about the virtues of protection, advocates of liberalization sometimes seem even more to live in a dreamland, believing that almost any trade agreement, especially with the United States or European Union, no matter how unfair, will magically bring investment and create jobs. They cite statistical studies claiming that trade liberalization enhances growth. But a careful look at the evidence shows something quite different. It shows that countries, like those in East Asia, that have become more integrated into the global economy have grown faster. It is exports—not the removal of trade barriers—that is the driving force of growth. Studies that focus directly on the removal of trade barriers show little relationship between liberalization and growth. The advocates of quick liberalization tried an intellectual

sleight of hand, hoping that the broad-brush discussion of the benefits of globalization would suffice to make their case.²²

Fair Trade versus Free Trade

Economists focus on how trade liberalization affects efficiency and growth. But popular discussions focus more on *fairness*. When people in the developed world talk of unfair trade, what they often have in mind is developing countries' huge advantage of low wages. But these countries have offsetting disadvantages as well, including a high cost of capital, poor infrastructure, lower skill levels, and overall low productivity. Those in the developing world complain equally vociferously of the difficulties of competing with the advanced industrial countries. Economists emphasize that these different strengths and weaknesses mean that each country has a comparative advantage, the things at which it is relatively good, and they should determine what it exports. It is not unfair to be poor and have low wages; it is unfortunate.

Too often, in political discourse, there is almost a presumption that if some country or firm is undercutting an American firm, it must be because that firm is playing unfairly. After all, American firms must be more efficient than those anywhere else; on a level playing field they would win. The dumping laws (often dubbed "fair trade laws"), described in greater detail later in this chapter, are almost based on this presumption: since American firms are more efficient, their costs must be lower; if foreign firms are outcompeting American firms, it must be because they are cheating—selling below cost. But this ignores the basic principle of trade: trade is based not on the absolute strengths of a country but on its relative strengths, on its *comparative* advantages; and even if America were more efficient in every industry (which it is not), industries in which it was *relatively* less efficient would find themselves losing to competition.

What, then, should one mean by fair trade? There is a natural benchmark: the trade regime that would emerge if all subsidies and trade restrictions were eliminated.²³ The world, of course, is nowhere near such a regime. Asymmetries in liberalization can benefit some groups at the expense of others. For instance, trade agreements now

forbid most subsidies—except for agricultural goods. This depresses incomes of those farmers in the developing world who do not get subsidies. And since 70 percent of those in the developing world depend directly or indirectly on agriculture, this means that incomes of the developing countries are depressed. But by whatever standard one uses, today's international trading regime is unfair to developing countries.²⁴

Even with an unfair trading system, China, India, and a few other developing countries have been growing enormously, and their growth is based in no small part on trade. But others have not been so fortunate. The unlevel playing field means that there will be more countries as a whole that lose, and more people even in successful countries who will lose. China, by most accounts one of the true winners in the global trade competition, faces a problem of growing inequality; its farmers are suffering because of American and European agricultural subsidies, which drive down prices. China and other developing countries face a cruel dilemma—they can spend scarce resources to subsidize their farmers in order to offset the developed world's largesse to theirs, but that will mean less to spend on development and therefore slower growth for the country as a whole.

THE HISTORY OF TRADE AGREEMENTS

Economists have been arguing for free trade for two centuries, but it was the Great Depression of the 1930s, more than abstract arguments, that was responsible for the wave of liberalization that began sixty years ago. Successive increases in tariffs in the late 1920s and early 1930s were thought to have played an important role in deepening the Great Depression. Each country saw its economy shrinking and so tightened restrictions on imports. These restrictions hurt other countries, which responded by tightening their own restrictions; as they did so, a vicious circle emerged. It was natural that after World War II, when global leaders sought to create a new, more prosperous international economic order, they not only sought to enhance financial stability through the creation of the International Monetary Fund but also attempted to establish an International Trade Organization (ITO) to regulate trade. This did not happen. The United States rejected the proposal for the

ITO in 1950 because of concerns on the part of some conservatives and corporations that it would lead to an infringement of national sovereignty and excessive regulation. It was not until forty-five years later that the World Trade Organization (WTO) came into being.

In the interim, trade negotiations led by the advanced industrial countries under the auspices of GATT, the General Agreement on Tariffs and Trade, greatly reduced tariffs on manufactured goods and created the foundations of the modern trade regime. The GATT system was built on the principle of nondiscrimination: countries would not discriminate against other members of GATT. This meant that each country would treat all others the same—all would be the most favored, hence the name: the most favored nation principle, the bedrock of the multilateral system. Alongside this went the principle of national treatment: foreign producers would be treated the same, and be subject to the same regulations, as domestic producers.

Trade negotiations occur in a series of rounds, in which many issues are put on the table, with complex bargaining among the countries. Each country agrees to lower tariffs and to open up markets if others reciprocate. By having enough issues on the table, it is hoped that negotiators can find a set of trade concessions that will make every country feel better off. GATT focused on liberalization of trade in manufactured goods, the comparative advantage of the advanced industrial countries. There was limited trade liberalization in the areas important for developing countries, such as agriculture and textiles. Textiles remained subject to strong limits (quotas) on a country-by-country, product-by-product basis;²⁵ likewise, agriculture remained highly protected and subsidized.

The Uruguay Round, the round of trade negotiations that began in Punta del Este, Uruguay, in September 1986, ended with an agreement signed in Marrakech on April 15, 1994. Under this agreement GATT, which had 128 member countries, was replaced by the World Trade Organization, which today has 149 member countries. Ministers from these countries meet at least every two years. The WTO was designed to provide a faster expansion of trade agreements, reaching into new areas like services and intellectual property rights, than had occurred under GATT.

Most important, for the first time there was an effective—if limited—enforcement mechanism. The WTO did not itself punish violators, but it authorized countries that had suffered injury as a result of a violation to retaliate by imposing trade restrictions on the offending country. The EU has become quite sophisticated in using this instrument against the United States. It draws up a long list of potential candidates for retaliation, targeting areas in which tariffs will be particularly painful, or goods produced in the districts of congressmen whom they are trying to sway. The threats have worked remarkably well.

The first step toward a rule of law in international trade was the great achievement of the Uruguay Round. Without a rule of law, brute power wins. The WTO's international law is an imperfect rule of law; the rules are derived from bargaining, including bargaining between the rich and the poor countries, and in that bargaining it is the rich and powerful that typically prevail. Enforcement is asymmetric—a threat of trade restriction by the United States against a small country like Antigua will elicit a response, but the United States does not pay much attention if Antigua threatens a trade restriction. Only when the practice affects a large number of countries—such as in the case of the cotton subsidies that the United States doles out to its farmers—is the threat of retaliation even credible.²⁶ Even so, an imperfect rule of law is better than none.

From Seattle to Cancún

Half a decade after the completion of the Uruguay Round, on November 30, 1999, the WTO convened in Seattle, Washington, for what was supposed to be the launch of a new round of trade negotiations, intended to be the crowning achievement of the Clinton administration's efforts at trade liberalization, which included the creation of NAFTA in 1994 and the World Trade Organization in 1995.²⁷ Instead, the meeting was a disaster. The negotiations were quickly overshadowed by massive street protests. Beginning at 5 a.m. on the first day of the conference, hundreds of activists began to take control of street intersections near the convention center. By the end of the day, the mayor had declared a state of civil emergency and imposed curfews, and

the governor had called up the National Guard. The scale of the demonstrations dwarfed any previous protest associated with globalization.

While the protestors represented a melange of views and did not offer any coherent alternatives, there was much to complain about (though the WTO itself should not have borne the brunt of the complaints; it simply provides a forum in which trade negotiations occur). The Uruguay Round had been based on what became known as the "Grand Bargain," in which the developed countries promised to liberalize trade in agriculture and textiles (that is, labor-intensive goods of interest to exporters in developing countries) and, in return, developing countries agreed to reduce tariffs and accept a range of new rules and obligations on intellectual property rights, investments, and services. Afterward, many developing countries felt that they had been misled into agreeing to the Grand Bargain: the developed countries did not keep their side of the deal. Textile quotas would remain in place for a decade, and no end to agricultural subsidies was in sight.

For forty years, trade liberalization had focused on opening up markets for manufactured goods—at the time, the comparative advantage of the United States and Europe. But I emphasized earlier the dynamic nature of comparative advantage: today it is China and other developing countries that have a comparative advantage in many areas of manufacturing. Unknowingly, for four decades, trade negotiators had been working to open up markets for China! With manufacturing in the developed world shrinking—today it represents only 11 percent of American employment and output—American and European trade negotiators would have to deliver something in services (which are now over 70 percent of America's economy, and nearly that in Europe and Japan) and in intellectual property to satisfy their constituents. They succeeded.

The list of complaints against the Uruguay Round trade agreement was long:

- It was so asymmetric that the poorest countries were actually worse off; sub-Saharan Africa, the poorest region with an average income of just over \$500 per capita per year, lost some \$1.2 billion a year.²⁸

the agenda—they set the agenda so that markets were opened up for the goods and services that represented their comparative advantage.

Western negotiators almost take it for granted that they can control what gets discussed, and determine the outcomes. As the United States and the EU push for opening up markets for services, they do not think (as they logically should): by and large, services are labor intensive; by and large, it is the developing countries that have an abundance of labor; and therefore, by and large, a fair service sector liberalization will be of especial benefit to developing countries. They think: we can liberalize the high-skilled services which represent our comparative advantage now, and we can make sure, one way or the other, not to liberalize services that are intensive in unskilled labor. From the very beginning of the discussion, they had in mind an unbalanced agreement.

Special interests are largely to blame—not special interests in the developing countries resisting trade liberalization, as proponents of trade liberalization complain, but special interests in the developed world shaping the agenda to benefit themselves, while leaving even the average citizen in their own countries worse off. The negotiators, in representing their immediate “clients”—the corporations that lobby them heavily and constantly, partly directly, partly through lobbying Congress and the administration—often lose sight of the big picture, confusing the interests of these companies with America’s national interests or, even worse, with what is good for the global trading system. And the story is much the same in other industrial countries. Within each country export-corporation interests pressure negotiators to get agreements that provide more access for their goods, while import industries press for protection. The negotiators strive not for intellectual consistency, not for an agreement based on principles, but only to balance the competing interests.

The Seattle protests sent an important message of discontent to the trade ministers, but the advanced industrial countries were not yet ready to give up on their push for further liberalization. The trade ministers met next at Doha in Qatar, a small country off the Persian Gulf, in November 2001—a far-flung location well chosen for those not wanting to be bothered by demonstrators questioning what was going

- Seventy percent of the gains went to the developed countries—some \$350 billion annually. Although the developing world has 85 percent of the world’s population and almost half of total global income, it received only 30 percent of the benefits—and these benefits went mostly to middle-income countries like Brazil.²⁹
 - The Uruguay Round made an unlevel playing field less level. Developed countries impose far higher—on average four times higher—tariffs against developing countries than against developed ones. A poor country like Angola pays as much in tariffs to the United States as does rich Belgium; Guatemala pays as much as New Zealand.³⁰ And this discrimination exists even after the developed countries have granted so-called preferences to developing countries. Rich countries have cost poor countries three times more in trade restrictions than they give in total development aid.³¹
 - The focus was on liberalization of capital flows (which developed countries wanted) and investment rather than on liberalization of labor flows (which would have benefited the developing countries), even though the latter would have led to a far greater increase in global output.
 - By the same token, liberalization of unskilled labor services would have led to a far greater increase in global efficiency than liberalization of skilled labor services (like financial services), the comparative advantage of the advanced industrial countries. Yet negotiators focused on liberalizing skill-intensive services.
 - The strengthening of intellectual property rights largely benefited the developed countries, and only later did the costs to developing countries become apparent, as lifesaving generic medicines were taken off the market and developed-world companies began to patent traditional and indigenous knowledge. (We will discuss this more fully in chapter 4.)
- The United States and Europe have perfected the art of arguing for free trade while simultaneously working for trade agreements that protect themselves against imports from developing countries. Much of the success of the advanced industrial countries has to do with shaping

on behind closed doors. The developed countries promised to make the talks a "development round"; in other words, they committed themselves to creating a trade regime that would actively enhance development prospects and redress the imbalances of previous rounds.³² The developing countries were hesitant to go along; they were afraid that another unfair trade agreement would be foisted on them, one which, like the last, would leave some of them actually worse off; they worried that, once the negotiations began, their arms would be twisted in one way or another and they would be forced to sign on to a new agreement against their best interests. They were skeptical about the promises being made at Doha; and, as the negotiations evolved over succeeding years, their skepticism seems to be have been justified.

The negotiations stalled over the refusal of the developed world to cut back on agricultural subsidies—in fact, in 2002 the United States enacted a new farm bill that nearly doubled its subsidies. In September 2003 the trade ministers met again at Cancún, which, in the local Mayan language, means "snake pit"—and so it proved for the negotiators. The ministers were supposed to appraise the progress that had been made and give directions to their negotiators for concluding the "development round." Despite still refusing to make concessions in agriculture or any other major issue of concern to the developing world—in effect, renegeing on their promise—the developed countries insisted on pushing their own agenda of reduced tariffs and opening access for the goods and services the EU and the United States wanted to export. They even wanted to impose new demands on the developing countries. While the advanced industrial countries still talked about a development round, it was mere rhetoric: there was a real risk that this new round, rather than undoing the imbalances of the past, would make them worse. The talks collapsed on the fourth day of the meeting. Never before had trade negotiations ended in such disarray.

The next global meeting of trade ministers in Hong Kong in December 2005—originally intended to wrap up the development round—did not end in disaster, but neither could it be called a success: Pascal Lamy, the head of the WTO, had managed to lower expectations so far that any agreement, even one which would have little effect on global

trade, would be viewed as the best that could be expected in the circumstances. More effort was put into managing the press than into making meaningful offers. The United States, which because of its huge cotton subsidies is the world's largest cotton exporter, to much fanfare offered to open its markets to African cotton producers—an offer worth little since it would not be importing much cotton (because of its huge cotton subsidies, America is a cotton exporter, not a major importer).

The era of multilateral trade liberalization seems to be nearing an end (at least for a while), as well-founded disillusionment in the developing countries combines with growing protectionist sentiment in the developed world. Whatever emerges from the so-called development round—if anything—will not be deserving of the epithet. It will do little either to create a trade regime that is fair to the developing countries or that will promote their development: tariffs imposed by developed countries against developing countries will still be far higher than those imposed against other developed countries, and developed countries will still be providing massive agricultural subsidies, doing enormous harm to the developing countries.

The real danger today is not that something will or will not be agreed to at the conclusion of the development round which will harm the developing countries significantly: the scale of reforms is so low that it is likely to matter little. Any eventual agreement will do only limited damage, or be of only limited benefit. The real danger is that the world will think that it has accomplished what was set out in Doha, so that, going forward, there is no need for a development round. Trade negotiators will then return to business as usual—another round of trade negotiations in which hard bargaining results in the lion's share of the gains going to the developed countries.

MAKING GLOBALIZATION WORK

Doha failed.³³ While it may be difficult to define precisely what is a fair global trade regime, it is clear that the current arrangements are not fair, and it is clear that the development round will do little to make

the trade regime fairer or more pro-development.³⁴ I believe, however, that it is possible to design a global trade regime that promotes the well-being of the poorest countries and that is, at the same time, good for the advanced industrial countries as a whole—though, of course, some special corporate interests might well suffer. This was, of course, the promise of Doha. The reforms would cost the developed countries little—in most cases nothing at all, as taxpayers would save billions from subsidies and consumers would save billions from lower prices—and developing countries would benefit enormously.

While Doha has failed to deliver on its promise, sometime in the future the challenge of creating a fair trade regime—and a trade regime that will give the poor countries of the world the opportunity to develop through trade—remains. There is a full agenda of reforms, going well beyond the agricultural issues on which so much of the discussion has focused: reforms that are both pro-poor and pro-development. These reforms are what a *true* development round would look like.

Developing Countries Should Be Treated Differently

Developing countries are different from more developed countries—some of these differences explain why they are so much poorer. The idea that developing countries should, as a result, receive “special and differential treatment” is now widely accepted and has been included in many trade agreements.³⁵ Developed countries are allowed, for instance, to deviate from the most favored nation principle by allowing lower tariffs on imports from developing countries—though even with this so-called preferential treatment, developed country tariffs against imports from developing countries are, as we have seen, four times higher than tariffs against goods produced by other developed countries.

The current system, however, makes preferential treatment completely voluntary, provided by each of the advanced industrial countries on its own whim. Preferences can be taken away if the developing country does not do what the granting country wants. Preferential treatment has become a political instrument, a tool for getting developing countries to toe the line.

Free trade for the poor: an extended market access proposal

One single reform would simultaneously simplify negotiations, promote more development, and address the inequities of the current regime. Rich countries should simply open up their markets to poorer ones, without reciprocity and without economic or political conditionality. Middle-income countries should open up their markets to the least developed countries, and should be allowed to extend preferences to one another without extending them to the rich countries, so that they need not fear that imports from those countries might kill their nascent industries. Even the advanced industrial countries would benefit, because they could proceed more rapidly with liberalization among themselves—which their economies are capable of withstanding—without having to satisfy the worries of the developing world. This reform replaces the principle of “reciprocity for and among all countries—regardless of circumstances” with the principle of reciprocity among equals, but differentiation between those in markedly different circumstances.³⁶

The European Union recognized the wisdom of this basic approach when in 2001 it unilaterally opened up its markets to the poorest countries of the world, taking away (almost) all tariffs and trade restrictions without demanding political or economic concessions.³⁷ The rationale was that European consumers would benefit from lower prices and more product diversity; while it would cost European producers a negligible amount, it could be of enormous benefit to the poorest countries; and it was a strong demonstration of goodwill. The European initiative should be extended to all advanced industrial countries, and markets should be opened up not just to the poorest but to all developing countries. (In one of the high points of hypocrisy and cynicism in the Hong Kong meeting in December 2005, the United States offered to open itself up to 97 percent of the goods produced by the least developed countries, a number carefully calibrated to exclude most of the products, such as Bangladeshi textiles and apparel, that it wanted to keep out. Bangladesh would be free, of course, to export jet engines and all manner of other products which are beyond its capacity to produce.)³⁸

Broadening developing countries' development agenda

Development is hard enough: we should not restrict what developing countries can do to help themselves grow. But that is what the Uruguay Round has done, as it restricts their ability to use a variety of instruments to encourage industrialization.

There is a difference between the effects on the global economy of agricultural subsidies given by the United States and Europe, which are allowed, and the subsidies that developing countries might want to give to help start new industries, or even to protect their industries and farmers against subsidized competition, which are prohibited. When the United States subsidizes cotton, global prices are affected; farmers in the developing world are hurt because of U.S. generosity to its farmers. (Economists call this an "externality.") But if Jamaica protects its milk producers, global prices are unaffected. Moreover, developing countries have limited tools to deal with the consequences of liberalization: the Jamaican dairy farmers who are put out of business as a result of America's highly subsidized milk industry have few viable alternatives. There are few jobs in the cities, and turning to some lower-paying alternative crop may make the subsistence farmer even poorer. The government has a tough choice to make: supplement the income of the individual farmers or spend government funds on an investment that the whole country needs. There is not enough money to do both. Protection against America's subsidized milk may be the only sensible alternative, at least in the short run.

If the extended market access proposal is adopted, then countries will have the scope to pursue their pro-development strategies and policies aimed at protecting their very poor citizens. But if it is not, then there must be exceptions that allow developing countries more leeway, especially to utilize uniform revenue-raising tariffs (the effect on imports being little different from that of a change in the exchange rate) and temporary industrial subsidies. As Europe has rightly pointed out, the United States often uses its defense expenditures to subsidize a range of industries. Boeing has benefited from military expenditures in aircraft design, and the software industry has benefited enormously from a whole range of government expenditures that helped develop the Internet and even the browser. Indeed, commercial benefits are

often put forward as one of the justifications for the huge level of defense expenditures. The United States is wealthy enough to afford an inefficient industrial policy hidden within its military; developing countries are not—and they should be free, if they choose, to have one appropriate to their circumstances.

Agriculture

A decade after the Uruguay Round, more than two-thirds of farm income in Norway and Switzerland came from subsidies, more than half in Japan, and one-third in the EU. For some crops, like sugar and rice, the subsidies amounted to as much as 80 percent of farm income.³⁹ The aggregate agricultural subsidies of the United States, EU, and Japan (including hidden subsidies, such as on water), if they do not actually exceed the total income of sub-Saharan Africa, amount to at least 75 percent of that region's income, making it almost impossible for African farmers to compete in world markets.⁴⁰ The average European cow gets a subsidy of \$2 a day (the World Bank measure of poverty); more than half of the people in the developing world live on less than that. It appears that it is better to be a cow in Europe than to be a poor person in a developing country.

The Burkina Faso cotton farmer lives in a country with an average annual income of just over \$250.⁴¹ He ekes out a living on small plots of semi-arid land; there is no irrigation, and he is too poor to afford fertilizer, a tractor, or high-quality seeds. Meanwhile, a cotton farmer in California farms a huge tract of hundreds of acres, using all the technology of modern farming: tractors, high-grade seeds, fertilizers, herbicides, insecticides. The most striking difference is irrigation—and the water he uses to irrigate the land is in effect highly subsidized. He pays far less for it than he would in a competitive market. But even with the water subsidy, even with all of his other advantages, the California farmer simply couldn't compete in a fair global marketplace were it not for further direct government subsidies that provide half or more of his income. Without these subsidies, it would not pay for the United States to produce cotton; with them, the United States is, as we have noted, the world's largest cotton exporter. Some 25,000 very rich American cotton farmers get to divide \$3 billion to \$4 billion in sub-

sidies among themselves, which encourages them to produce even more. The increased supply naturally depresses global prices, hurting some 10 million farmers in Burkina Faso and elsewhere in Africa.⁴²

In globally integrated markets, international prices affect domestic prices. As global agricultural prices are depressed by the huge American and EU subsidies, domestic agricultural prices fall too, so that even those farmers who do not export—who only sell at home—are hurt. And lower incomes for farmers translate into lower incomes for those who sell goods to the farmers: the tailors and butchers, storekeepers and barbers. Everyone in the country suffers. The subsidies may not have been intended to do so much harm to so many, but this is the *foreseen* consequence.

The most often-heard reason for continuing these subsidies in the United States is that subsidies are essential to maintaining the small family farmer and traditional ways of life. But the vast bulk of the money goes to large farms, often corporate ones. These subsidies have become simply another form of corporate welfare. Looking across all crops, some 30,000 farms (1 percent of the total) receive almost 25 percent of the total amount spent, with an average of more than \$1 million per farm. Eighty-seven percent of the money goes to the top 20 percent of the farmers, each of whom receives on average almost \$200,000. By contrast, the 2,440,184 small farmers at the bottom—the true family farmers—get 13 percent of the total, less than \$7,000 each.⁴³ The huge subsidies—including the allegedly non-trade-distorting ones—actually drive out the small farmer. When farming becomes more lucrative because of the subsidies, the demand for land is increased, driving up the price. With the price of land so high, farming has to become capital-intensive. It has to make heavy use of fertilizers and herbicides, which are as bad for the environment as the increased output is for farmers in the developing world. As a result, small farmers, who don't have the resources for this kind of capital-intensive farming, find it attractive to sell out to large farmers and cash in the capital gain. As land increasingly moves to the large farms, with their heavy use of fertilizers, herbicides, and technology, output increases further, and those in the developing world are hurt once again.⁴⁴

If the developed countries believe they need a transition period for

the abolition of subsidies, it should be done by eliminating all subsidies to farmers making in excess of, say, \$100,000, and capping subsidies to any one farmer at, say, \$100,000.

Since the vast majority of those living in developing countries depend directly or indirectly on agriculture for their livelihood, eliminating subsidies and opening agricultural markets would, by raising prices, be of enormous benefit. Not all developing countries, however, would benefit. Importers of agricultural goods would suffer as prices rise. Among and within the developing countries, there would be losers and winners: farmers would be better off, while urban workers would face higher food prices. The way to solve this transitional problem would be for industrial countries to provide assistance to help the developing countries through the adjustment period—even a fraction of what they now spend on agricultural subsidies would do.

Cotton is an exception. If cotton subsidies were removed, the effect on producers would be significant but the effect on consumers would be negligible. Since the cost of the raw material represents such a small fraction of the value of a finished garment, a substantial increase in the price of cotton would hardly be reflected in the prices paid for textiles and apparel. This is one of the reasons that there is currently such a strong demand by developing countries for the elimination of cotton subsidies.

Escalating Tariffs

While reducing agricultural tariffs and subsidies has received enormous attention, that is not enough to create fairness. Tariff structures themselves need to be made pro-development. One would think that agricultural countries could can the fruits and vegetables they grow, and so earn more than they make from exporting raw produce. It would be easy to do and would create jobs. But they do not, because developed countries design their tariffs in a way that discourages this kind of industrializing, by placing higher tariffs on manufactured goods than on raw materials; the more manufacturing involved, the higher the tariff. This is known as tariff escalation.

Here is how it works. Consider as a hypothetical example an agricultural product, like oranges, that a developed country does not pro-

duce itself. Europe may let fresh oranges enter with low duties—assume it is zero—because it has a relatively small domestic orange-growing industry to protect. But it imposes a 25 percent tariff on various forms of processed oranges, from orange marmalade to frozen orange juice. Assume that half of the value of orange marmalade is in the processing, half in the orange ingredient. The tariff is clearly just a tax on processing in the developing country. There is, in effect, a 50 percent tariff on the processing activity, so that the developing country's costs would have to be much, much lower for it even to hope to compete with the canners in the developed country. Through escalating tariffs, Europe continues to receive a supply of cheap oranges while reducing the competitive threat posed to processing industries by developing countries.⁴⁵

The market access proposal—free access for developing countries to the markets of the advanced industrial countries—would obviously solve the problem of escalating tariffs. In recent trade discussions, the developed countries have focused on getting developing countries to lower their high tariffs.⁴⁶ The focus should shift: the first priority should be the elimination of escalating tariffs. What matters is not just nominal tariff rates but effective tariff rates—tariffs on value added; and the high effective tariffs on value added by industry in developing countries should be reduced drastically.

Unskilled-Labor-Intensive Services and Migration

Developed countries are rich in capital and technology, while developing ones have an abundance of unskilled labor. What each country produces reflects its resource endowment. A country with skilled labor produces skill-intensive goods and services. The Uruguay Round expanded trade negotiations into the area of services. But, not surprisingly, it covered the liberalization of services such as banking, insurance, and information technology—all sectors in which the United States has an advantage—while leaving unskilled services, such as shipping and construction, entirely off the agenda.

Some forty countries, including the United States, have laws requiring the use of local ships for transporting goods domestically. In the United States, the Jones Act of 1920 requires not only that the ships be

owned by Americans but that they be built in American shipyards and manned by Americans. (The history of protectionism goes back much further, to the first session of Congress in 1789.) America does not have a comparative or absolute advantage in shipping—indeed, as long ago as 1986, it was estimated that the Jones Act cost America more than \$250,000 for every job it saved.⁴⁷ Shipping provides a wonderful opportunity for a pro-poor trade agenda that would focus on unskilled-labor-intensive services.

A similar argument arises for movements of labor and capital themselves. The developed countries are rich in capital, which moves around the world looking for the highest returns. Developing countries have an abundance of unskilled workers, who want to move around the world in search of better jobs. For the past couple of decades, the United States and the EU have pressed, with considerable success, for liberalization of capital markets, which enables investment to flow more freely around the world, arguing that this is good for global efficiency. But even modest liberalization of labor flows would increase global GDP by amounts that are an order of magnitude greater than the most optimistic estimates of the benefits of capital market liberalization. Furthermore, liberalizing migration would benefit developing countries.⁴⁸ For one thing, workers employed in the developed world send remittances back home; already billions of dollars are being sent back every year. In 2005, Mexico received an estimated \$19 billion in remittances, second as a source of foreign exchange only to oil; for Latin America as a whole, remittances in 2005 were \$42 billion.⁴⁹ But the cost of sending remittances can be very high, eating up a significant fraction of the amount sent. Developed countries need to facilitate the transfer of remittances to developing countries (as the United States is already doing), so that these countries can reap the full benefits of migration.⁵⁰

Developed countries do, of course, allow the migration to their countries of high-skilled labor, because they see clearly the benefit to themselves of doing this. But as we noticed in the last chapter, this amounts to taking the developing countries' most valuable intellectual capital without compensation: after the developing countries have invested their scarce dollars in education, the developed countries, often inadvertently, try to skim off their best and brightest.

The asymmetry in liberalization of capital and labor flows leads to a further inequity. With capital markets liberalized, countries have to fight to keep capital by lowering taxes on corporations. Because labor—especially unskilled labor—is not as mobile, they don't have to fight as hard to keep it. Hence asymmetric liberalization leads to shifting the burden of taxes on to workers—leading to reduced progressivity in the tax system. The same thing happens in wage bargaining: workers are told that if they do not accept lower wages and reduced protection, the capital (with its jobs) will move overseas.

Nontariff Barriers

The reduction or elimination of tariffs does not eliminate protectionist sentiments or politics; it just forces them to find new outlets. Not surprisingly, as tariffs have come down, the advanced industrial countries have been particularly clever in erecting nontariff barriers. These take a number of forms.

Safeguards

Safeguards are temporary tariffs that can, in principle, play an important role in helping a country adjust as it faces an unanticipated large increase in the level of imports, a "surge." The tariffs keep out, temporarily, the foreign imports, providing the industry needed time to make an adjustment—for instance, to improve efficiency, or for workers to find an alternative job. Developing countries have probably not made as much use of safeguards as they should. At the other end of the spectrum, the United States has repeatedly abused safeguard measures, often employing them to protect an industry in decline—like steel—even when a surge of imports has relatively little to do with the underlying problem.⁵¹

The justification for invoking safeguards should not be solely the loss of jobs or sales from an increase in imports from a particular country; it ought to be shown that there is a causal link between the import surge and the industry's problems. For instance, an increase in textile imports from China, when matched by a decrease in imports from Bangladesh, should not constitute a situation requiring surge protections. And it should not be left to each country's administrative courts,

with all their sensitivities to political pressures, to decide whether a safeguard tariff is justified. There should be international standards, enforced by internationally appointed tribunals. Such a tribunal, for instance, would probably not give a very sympathetic ear to American and European claims for safeguard protection from the surge of textile imports after the elimination of textile quotas in January 2005—given that there had been a ten-year transition period during which the developed countries were supposed to gradually phase out protection in order to ease transition, and during which, in fact, they did nothing.⁵²

Dumping duties

The nontariff barrier most preferred by the United States has been dumping duties, which were designed to stop the peculiar unfair trade practice of selling goods below cost. While safeguard measures are temporary, dumping duties can be permanent. America has accused Mexico of dumping tomatoes, Colombia of dumping flowers, Chile and Norway of dumping salmon, China of dumping apple juice and honey. Today, Chilean wine growers worry that should they continue to be successful, California wine producers will demand that the United States impose dumping duties. Dumping duties deter entry and cast a pall over the entire market: any firm worries that, should it succeed in entering the American market with a new product, it will face dumping duties that will render it uncompetitive.

In the 1990s, Vietnam started exporting catfish into the United States, and it quickly became Vietnam's biggest export market. Soon, Vietnam had taken 20 percent of the U.S. catfish market, and furious U.S. catfish producers got Congress to pass a law stating that only U.S. catfish could be sold under the name catfish.⁵³ But Vietnam outsmarted the United States, reentering the American market with a new name, basa, rebranding their catfish as an upscale and exotic foreign product. Now, not only were they displacing Mississippi catfish; they were also getting a higher price. This time, the United States responded even more aggressively. Since one nontariff barrier had failed, it would use another, dumping duties, charging that Vietnam was selling below costs.

Rational firms do not sell below cost unless they believe they can

thereby attain a monopoly position, which they can maintain long enough not only to recover what they have lost but to make a return on their investment (their losses from selling below cost). American anti-trust law recognizes this. Under American law, for charges of predatory pricing (as it is called when a company sells below cost to drive out a domestic rival) to be sustained, it has to be shown that there must be the prospect not only of monopolization but of maintaining that monopoly long enough to recoup the losses. Predation (true dumping) does occur, though it is rare because it is hard to establish a durable monopoly. But American law on competition from international firms does not recognize this basic economic logic. In few of the dumping cases is monopolization—let alone durable monopolization—even a remote possibility. Mexico cannot get a monopoly on tomatoes, Colombia cannot get one on flowers. Yet dumping charges are not only brought; dumping duties are levied. The reason is that costs are measured in ways that often have little to do with economic realities or principles. Dumping laws are not designed to discern whether a firm is selling below its (marginal) cost; they are designed to get a high cost number so that dumping duties can be levied. No wonder, then, that rational firms so often are found to be selling below cost.⁵⁴

Matters are even worse when a nonmarket economy is accused of dumping. (China, in spite of its progress toward a market economy, is still treated as a nonmarket economy.)⁵⁵ In the case of nonmarket economies, the costs used to calculate whether goods are being dumped are not the actual costs, but what the costs would be in some surrogate country. Those seeking to make a dumping charge stick look for a country where costs will be high, so that high dumping duties can be levied. In one classic case, in the days before the fall of the Berlin Wall, the United States levied dumping duties against Polish golf carts, using Canada as the surrogate country. Costs in Canada were so high that Canada did not produce golf carts, so dumping duties were levied on the basis of a calculation of what it would have cost Canada to produce golf carts, if Canada were to have produced them. In many places, including the EU, the surrogate country can even be the country bringing the charge—in which case, almost by definition, costs are greater, otherwise there would be no trouble competing.

One recent export from the advanced industrial countries is the use of nontariff barriers as protectionist devices. Developing countries are increasingly using them against each other. India, for instance, used Indian costs in bringing a dumping charge against China in the case of an important chemical, isobutyl benzene. In the case of low-carbon ferrocromium from Russia, India chose Zimbabwe as the surrogate country, presumably because of its high electricity prices—the key determinant of costs—and levied dumping duties on that basis.

There is a double standard. If America's own domestic standard for ascertaining predatory pricing were used internationally (when America charges a foreign firm with selling below cost), few, if any, dumping cases would succeed. If the standard the United States uses against foreigners were used domestically, a majority of American firms would be found guilty of dumping. This is an important exception to the principle that the United States heralds as so important: nondiscrimination. Foreign producers are clearly being treated differently from domestic producers.⁵⁶

There should be a single standard for unfair trade practices, which would apply both domestically and internationally. There should be a single law dealing with dumping and with predatory pricing (as there is in the trade agreement between Australia and New Zealand). The presumption should be that firms—whether at home or abroad—do not willingly sell at a loss, and the accuser should be required to show that there was a reasonable prospect of attaining sufficient market power for long enough to recoup the losses.

Part of the problem with dumping duties, as with safeguards, is the procedures by which these duties are levied. I saw this repeatedly while I was in the Clinton administration. We would bring dumping charges (even though selling goods at a low price benefits American consumers). We would be prosecutor, judge, and jury, and the rules of evidence would have made a judge in a kangaroo court blush. The evidence relied on was often that presented by the domestic competitor, who wanted his rivals snuffed out of the market. (In 2000, the Byrd amendment provided an additional incentive: any dumping duties levied would be turned over to the affected industry—i.e., to those who brought the charges.)⁵⁷ On the basis of this information,

high duties would be imposed preliminarily, causing the exporter to lose sales and go out of business. A year or two later, after a full investigation, revised and often much lower duties would be announced—but by then the damage had already been done.⁵⁸

Again, what is needed is an international tribunal to judge whether a country is guilty of dumping (or engaging in other unfair trade practices). The current system, where each country can set its own standards and do its own cost calculations in such a way as to make a finding of dumping more likely, should be viewed as unacceptable in a world in which there is a rule of law governing trade.

Technical barriers

International trade is complex, with complicated rules that govern it, and these rules often constitute an important barrier to trade—sometimes deliberately so.

Phyto-sanitary conditions are restrictions imposed to protect human or animal life from risks arising from, say, diseases or additives in imported agricultural goods. The difficulty is in determining whether these represent legitimate concerns or are a trade barrier in disguise. The United States claims that other countries' use of such restrictions against its produce—such as genetically modified food—are trade barriers, but its own restrictions—such as the invisible fruit flies that were at one time the justification for excluding Mexican avocados from the United States—are reasonable. Brazil claims that restrictions on exports of fresh beef to the United States on grounds of foot-and-mouth disease are unjustified; some areas of that vast country have been certified free from the disease, yet the United States refuses to allow in any Brazilian beef shipments. The Chinese government has estimated that some 90 percent of its agricultural products are affected by technical barriers, costing it some \$9 billion in lost trade.

Of all the nontariff barriers, this is the most difficult to deal with. Governments have a right—and an obligation—to protect their citizens, and distinguishing between protectionist uses and legitimate standards is not easy. Some have called for the use of "scientific" standards, but it is not even clear what should be acceptable levels of tolerance of risk. The "scientific" risk from genetically modified foods *may*

be low, but a large number of people in the world still think the risk is unnecessary and unacceptable. At the very least, countries should have the right to demand labeling. The United States has argued against this, worried that labeling would discourage purchase—this is strange given its commitment in other contexts to the principles of consumer sovereignty, which is meaningful only if consumers know what they are buying.

While there is no easy answer, a system of international tribunals (as in dumping and safeguards) would at least move the deliberations out of the protectionist environments in which they are now conducted. Judges would be able to ascertain the weight of evidence. Brazilian beef might be required to be labeled as Brazilian beef, but if the scientific evidence suggests that there is no significant risk from foot-and-mouth disease from beef from the certified disease-free areas, then importation should be allowed.

Rules of origin

When developed countries give preferences to developing countries or sign free trade agreements, they want to be sure that the goods admitted are goods actually produced in the country concerned. They don't want the only thing made in Mexico on a shirt with the label "made in Mexico" to be the label itself. The rules that define what makes something Mexican or Moroccan (or any other nationality) are called "rules of origin." But in our complicated global economy, everybody is interdependent. No country makes all the components of what it sells. An apparel maker may import textiles, dyes, or buttons. The machines it uses may be imported too—along with the oil on which the machine is run. If three small countries next door work together—one doing the packaging, another the cutting, another the sewing—none may satisfy the rules-of-origin tests. An apparel manufacturer might only be able to export apparel if he uses textiles produced in his own country; a textile manufacturer might only be able to export textiles if he uses cotton grown in his own country.

Rules of origin can undo the benefits of preferences or free trade. The threshold is sometimes set at a level just high enough to deny benefits. If the exporting country itself imports the cloth, and 50 percent

of the value of the shirt is the imported cloth, the importing country sets the rules-of-origin threshold at 55 percent. (Even if it is set at 50 percent, expensive shirts made with high-grade cotton will be excluded.) The United States has even used rules of origin to promote its own exports: countries that make shirts using American cotton are given preferences which those who use the least expensive cotton are not.

Sometimes the problems that arise with rules of origin are ascribed to technical glitches, but the frequency with which they arise suggest that they are used deliberately as a protectionist measure. Complicated calculations and arbitrary rules are used. Exporters are forced by these agreements to choose inputs that satisfy rules-of-origin tests rather than inputs of a given quality at the lowest price. Some producers forgo preferential treatment simply because the cost of documentation is greater than the benefit.⁵⁹

Restricting Bilateral Trade Agreements

After the failure of Cancún, the United States announced that it would push for bilateral trade agreements. These agreements undermine the movement toward a multilateral free trade regime. As was noted, among the most basic precepts that have guided the expansion of trade has been the principle that all nations would be treated the same. The United States' bilateral trade agreements say clearly that the United States will treat some countries better than others. Often these agreements do not even expand trade—they simply divert trade from less favored to more favored countries. Sometimes they are justified by the United States as a precursor to broader multilateral agreements, but in fact these preferential arrangements make it more difficult to reach broader agreements, since inevitably such agreements will take away the privileges—and those favored with the privileges will resist.

In bilateral bargaining, the balance of power between the United States and the developing countries is even more lopsided, and the agreements signed so far reflect that. The United States has succeeded in getting some provisions into bilateral agreements that it failed to get into the Doha Round of talks, such as strengthened intellectual property rights and capital market liberalization. Sometimes developing countries sign these agreements under the illusion that, with such an

agreement in place, investors will flock to their country. With Washington's seal of approval and duty-free access to the United States, there will be a boom. But sometimes, developing countries sign these agreements largely out of fear: fear, for instance, that if they don't, they will lose the preferences that they have long had, and that without preferences they will not be able to compete with the flood of imports from countries like China.⁶⁰ While a number of agreements have been signed, they are with small countries—such as Chile (population 16 million), Singapore (population 4.3 million), Morocco (population 30.8 million), Oman (population 2.5 million), and Bahrain (population 750,000)—and so involve only a tiny fraction of global trade. The bilateral strategy has thus, so far, largely failed. Meanwhile, developing countries are responding in kind, with agreements already made or in the works within Latin America and Asia. The multilateral system is in the process of fraying.

Bilateral trade agreements should be strongly discouraged; at the minimum, an independent international panel should judge whether a bilateral agreement leads to more trade diversion than trade creation. If it does, the agreement should not be allowed.

Institutional Reforms

Governance—problems in the ways decisions get made in the international arena—are at the heart of the failures of globalization. How decisions get made, what gets put on the agenda, how disagreements are resolved, and how the rules are enforced are, in the long run, as important as the rules themselves in determining the outcome of the international trade regime—and whether it is fair to those in the developing world. This is as true in the arena of trade as it is elsewhere.

The problems of unfairness start in the beginning: with setting the agenda. We have seen how the past focus on manufacturing has moved to high-skill services, capital flows, and intellectual property rights. A development-oriented trade agenda would be markedly different. First, it would remain narrowly focused on those areas where a global agreement is needed to make the international trade system work. The developing countries simply don't have the resources to negotiate effectively on a broad range of topics. And (second) it would focus on areas

of benefit to developing countries: unskilled-labor-intensive services and migration. There are some new topics that would be added: circumventing bribery, arms sales, bank secrecy, and tax competition to attract businesses, all of which hurt developing countries, and all of which can only be controlled by international cooperation.⁶¹

The problems in governance are highlighted by the manner in which negotiations occur. The issue of openness in international discussions has long been a major concern. President Woodrow Wilson put "open covenants . . . *openly arrived at*" (my italics) at the head of his agenda for reforming the international political architecture in the aftermath of World War I, going on to argue that "diplomacy shall proceed always frankly and *in the public view*" (my italics).⁶² But this has never been the case—or even a declared objective—in trade negotiations. Typically the United States and the EU would together select a few developing countries to negotiate with—often putting intense pressure on them to break ranks with other developing countries—in the Green Room at the WTO headquarters. (Today, even when the negotiations occur in Cancún, Seattle, or Hong Kong, the room in which the representatives huddle is still called the Green Room, with all the negative connotations.) Having trade ministers closeted in a room, separated from the experts on whom they rely, negotiating all night, may be a good test of endurance, but it is not a way to create a better global trade regime. Worse still, special interests are far more likely to influence international negotiations when they are conducted under the cloak of secrecy.

The justification for these secret, high-pressure negotiations is that it is impossible to negotiate with dozens of countries at a time. That is certainly true, but there are ways to make the negotiation process fairer and to have the voices of developing countries heard more clearly.⁶³

Compounding the problems of an unfair agenda and unfair and nontransparent negotiations is unfair enforcement. As we have noted, the enforcement mechanism is asymmetric. Antigua won a major case against the United States on online gambling, but there was no way that Antigua could effectively enforce the decision. Putting tariffs on American goods would simply raise prices for the people of Antigua, making them worse off. But there is a simple solution, which would go

some way toward creating a more effective and fair enforcement mechanism: allowing developing countries, at least, to sell their enforcement rights.⁶⁴ Europe, for instance, might have some grievance against the United States in a pending case; rather than waiting for the outcome of that case, it could use the threat of enforcement action in the already-decided case to induce a quicker resolution.

I have laid out an ambitious set of reforms of the international trade regime, one which could make an enormous difference for developing countries. At the Millennium Summit in New York in September, the international community committed itself to reducing poverty; at Monterrey, Mexico, in March of 2002, the advanced industrial countries committed themselves to providing 0.7 percent of their GDP to help achieve this goal. If the world is genuinely committed to doing something about global poverty, and willing to give so much money to help the poor, it should also be willing to enhance opportunities—and especially opportunities for trade. The world needs a true development round, not the repackaging of old promises that the West tried to sell as a development agenda and then didn't even live up to.

Any trade agreement involves costs and benefits. Countries impose constraints on themselves in the belief that reciprocal constraints accepted by others will open up new opportunities, the benefits of which exceed the costs. Unfortunately, for too many developing countries this has not been the case. Unless the direction in which negotiations have been going in recent years is changed dramatically, more and more developing countries are likely to decide that no agreement is better than a bad one.

But what are the prospects of a fairer trade regime? Trade liberalization has not lived up to its promise. But the basic logic of trade—its potential to make most, if not all, better off—remains. Trade is not a zero-sum game, in which those who win do so at the cost of others; it is, or at least it can be, a positive-sum game, in which everyone can be a winner. If that potential is to be realized, first we must reject two of the long-standing premises of trade liberalization: that trade liberalization automatically leads to more trade and growth, and that growth will

automatically "trickle down" to benefit all. Neither is consistent with economic theory or historical experience.

If there is to be support for trade globalization in the developed world, we must make sure that the benefits and costs are more evenly shared, which will entail more progressive income taxation. We have to be particularly attentive to those whose livelihood is being threatened, and this will require better adjustment assistance, stronger safety nets, and better macro-economic management—so that when individuals lose their jobs, they can find better ones. We have to put in place policies that will lead wages, especially at the bottom—which in the United States have stagnated for years—to rise. Globalization will not be sold by telling workers that they can still get a job if only they lower their wages enough. Wages can rise only if productivity increases, and this will require more investment in technology and education. Unfortunately, in some of the advanced industrial countries, most notably the United States, just the opposite has been happening: taxes have become more regressive, safety nets have been weakened, and investments in science and technology (outside the military) have been declining as a percentage of GDP, as has the number of graduates in science and technology. These policies mean that even the United States and other advanced industrial countries that follow America's lead—the potential big winners from globalization—will gain less than they otherwise would; and these policies mean that more people within these countries will see themselves as losing from globalization.

With these reforms, the prospects of a globalization that will benefit most will be enhanced, and, with that, so too will support for a fairer globalization. With globalization, we have learned that we cannot completely shut ourselves off from what is going on elsewhere. The advanced industrial countries have long benefited from the raw materials they get from the developing world. More recently, their consumers have benefited enormously from low-cost manufactured goods of increasingly high quality. But they have also been affected by illegal immigration, terrorism, and even diseases that move easily across borders. For many, helping those in the developing world, those who are poorer, is a moral issue. But increasingly, those in the advanced industrial countries are recognizing that such help is also a matter of self-

interest. With stagnation, the threats of disorder from the disillusioned facing despair will increase; without growth, the flood of immigration will be difficult to stem; with prosperity, the developing countries will provide a robust market for the goods and services of the advanced industrial countries.

I remain hopeful that the world will sooner or later—and hopefully sooner—turn to the task of creating a fairer, pro-development trade regime. Demands for this by those in the developing world will only grow louder with time. The conscience and self-interest of the developed world will eventually respond. When that time comes, the program laid out in this chapter will provide a rich agenda for what can and should be done.