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Policy Brief

S U M M A R Y

Following the riotous 1999 meeting in Seattle, and a near failure in Doha in 2001, the World Trade Organization dedicated the current round of trade liberalization talks to “development.” Negotiators will meet in Cancun, Mexico, in September amid competing claims regarding what steps are necessary to make trade serve development goals. The catch phrases of international trade—“comparative advantage,” “the development round,” “trade not aid,” and “level playing field”—hide tough choices for both developing and developed country governments. Getting trade rules right is not sufficient for development, but getting them wrong can cripple it. The authors outline the policies that governments and international institutions will need to avoid a debacle at Cancun and to assist developing countries in achieving long-lasting growth. ■

Decoding Cancun: Hard Decisions for a Development Round

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Cancun is coming, and with it growing concern about its outcome. This will be the first gathering of Ministers from World Trade Organization (WTO) member states since the November 2001 WTO meeting in Doha, Qatar. There, negotiators managed to avoid a repeat of the riotous collapse of negotiations at Seattle in 1999 and to launch a new round of trade talks due to the shock of 9/11 and a last-minute agreement to dedicate the new round to development. Without this commitment to make further trade liberalization narrow the gap between rich and poor countries and to redress problems that poorer countries blamed on prior trade pacts, the developing world likely would have walked away from the negotiations.

Just two years later, expectations have been dashed. Negotiators have missed all the carefully orchestrated deadlines for incremental progress on developing country concerns. Antiglobalization groups are mobilizing for Cancun. Masses of Mexican peasants and small farmers also plan to march to draw the world's attention to what they see as devastating losses to their liveli-

hoods under current trade rules. Trade officials from the United States, European Union, and other trading powers are again scrambling to avoid the public disagreement that led to failure at Seattle.

In economic theory, free trade benefits everyone, even the least advantaged. Unfortunately, the real world falls short of trade theory. In the real world, economic competitors use governments to shape national policies and to negotiate the rules of international trade. From another direction, nonprofit champions of social and environmental causes seek to establish rules that limit or redress the social costs of liberalized trade. The permutations of conflicting interests are endless, as are the angles they play in trade negotiations.

In the contest over trade rules since the 1950s, leading countries as well as global institutions such as the WTO, the World Bank, and the International Monetary Fund (IMF) have exerted their power to broaden and deepen states' commitments to the liberal international trading system as the best way to produce overall gains. Yet, the intense discord from Seattle to Doha



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and now Cancun suggests that large numbers of people are losing faith in both economic liberalism and the judgment of the Bretton Woods institutions. Some do not like the environmental, cultural, and other effects of the type of economic growth produced through this system. Many dislike the distribution of benefits, arguing essentially that the rich get richer and the poor get poorer—between countries and within them.

Because free trade is so hotly contested, its proponents have developed concepts and phrases that explicitly or implicitly defend it against charges that practice falls short of theory. But the catch phrases of international trade—“comparative advantage,” “the development round,” “trade not aid,” and “level playing field”—hide tough choices that developing and developed governments must make to ameliorate concerns that the existing trade system is not living up to its promise.

True amelioration and affirmation of free trade will come only if the concepts reflected in these terms are enacted in the real world. For this to occur, rich and developing countries alike must devote much greater political will to living up to the principles and commitments they claim to support. The “invisible hand” of the market will not create the benefits that people around the world demand unless the visible hands of governments and trade negotiators correct the distortions and failures of the global marketplace.

Comparative Advantage

The theoretical basis for believing that trade liberalization is good for everyone is the notion of comparative advantage. This theory posits that when states trade, each will adjust to do what it is relatively better at. Rather than trying to provide all its economic needs on its own, state A can make more money specializing and selling what it does best while buying from states B and C what they produce best. Everyone will gain based on their relative efficiency. The problem with the theory is that some states may be so efficient that they are able to supply the needs of all in multiple markets. For example, it is widely believed that

China has the capacity to supply the entire world with apparel and to do so with greater efficiency than any other country. Suppose at the same time that some big agricultural producers are so efficient—or so well subsidized by their rich governments—that they can sell food more cheaply than the poorest developing countries. That would leave many states without any effective comparative advantage and with domestic economies that are too weak to create new global niches. In theory, a person, company or country that loses its comparative advantage to a rival will then adjust and find a new comparative advantage. However, in reality, some countries—like some unemployed workers or failed companies—may not be able to adjust within a tolerable time frame and may be left worse off than they were before trade liberalization. Without special provisions in trade rules or other related affirmative action, some poor countries will be unable to compete in the global economy.

The Development Round

When the United States and other rich countries agreed at Doha to make this round of trade negotiations the development round, they created legitimate expectations that further trade liberalization and rule refinement would specifically aim at helping developing countries. Rich countries would take special care to open their markets to poor countries' goods and services and to remove subsidies that give their producers special advantages against countries that cannot afford such subsidies. Developing countries also would lower subsidies and open their markets, but more slowly and in ways that reflect their relative economic weaknesses. And rich countries would make special efforts to help developing countries build the economic and institutional capacities to compete in the more open international system. Through this sort of affirmative action, trade rules would be added or adapted to remedy developing country disadvantages. As noted earlier, this commitment was born of necessity—developing countries' agreement was required to launch further trade talks. But it also reflected the

recognition that only a few developing countries (notably China, the Indian information technology sector, and some other East Asian states) had experienced much benefit from trade liberalization to date.

Modern economic development almost always entails attracting capital from abroad to complement an abundance of labor or to exploit valuable natural resources. The resultant agricultural and extractive goods or manufactured products must then find markets, including in richer foreign countries, where consumers can afford to buy them.

However, the experience of many countries shows that simply opening borders to flows of products and investment does not guarantee development. Trade may grow, even dramatically, but the gap between rich and poor may widen, as happened in Mexico. Lasting development must also include broad participation by society in the economic growth that occurs so that domestic markets for agricultural and manufactured goods grow as well. If incomes rise for large segments of the population, growing domestic demand for food attracts continuing investment in agricultural productivity and allows labor to move gradually from subsistence agriculture into new job opportunities in nonagricultural sectors that add greater economic value. If crops and goods also find export markets, the process can move forward at a faster pace than with domestic markets alone.

Development also requires predictable rules and representative institutions that enable societies to resolve disputes over distribution of the gains and pains of economic growth, so that progress is not undermined or destroyed altogether by social instability or ecological degradation. Good governance, democratic systems that ensure transparency, accountability, and the rule of law all help developing countries set priorities that reflect public will and minimize government corruption. Clearly trade—and the disciplines of trade rules—can facilitate these features of development. Just as clearly, trade is not enough.

What makes the relationship between trade policy and development much more

complicated, however, is that trade rules have been written to advantage particular interests in powerful countries. The temptation to protect one's own is natural; all trading partners, rich and poor, try to maximize their gains. But rich and powerful countries are more likely to succeed. Depending on the specific nature of the resulting rules, freer trade can hurt developing countries.

For example, access to wealthy markets for agricultural products can help poor countries take advantage of their surplus land and labor. However, if agricultural trade rules require poor countries to open their markets to all foreign agricultural products, food that is produced more efficiently or with the help of government subsidies in wealthy countries can quickly wipe out small and subsistence farmers. If small-scale farming comprises a large proportion of the workforce (and farming employs 60 percent or more of all workers in many poor countries), there is little chance that those farmers can be absorbed in a reasonable period into other sectors that may be expanding. As a result, poverty and hunger may increase, not decrease, and urban slums will grow with attendant public health and environmental problems.

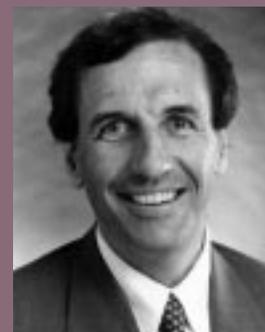
In other words, getting trade rules right is not sufficient for development, but getting trade rules wrong can damage development. At Doha, WTO members explicitly agreed that they would take into account the needs of developing countries. These commitments, and the expectations that they prompted, cannot be retracted without great cost to international development and the trading system itself.

Trade Not Aid

Trade not aid has become a popular mantra. It implies that free trade will allow countries to grow and develop based on their own (good) effort, rather than through (bad) dependency on aid. But the actual changes in development aid, trade flows and capital flows to foreign destinations suggest that trade not aid is an ex post justification for anemic levels of aid provided by rich countries. (See figures.)



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An emphasis on trade is fine, if the overall levels of aid and trade combined effectively help poor countries develop and compete. But the recent move away from development assistance has not been matched by commensurate increases in trade. At the same time, developing countries are not gaining the capacity and assistance necessary to compete effectively in international markets. They still lack many of the basic institutions necessary to protect rights and establish the rule of law, or to prepare their citizens to compete in world markets through rising levels of education and health. As important, they lack the resources to create social safety nets that protect social welfare when newly opened markets impose sudden and large adjustment costs.

The United States' Millennium Challenge Account and the WTO's Doha Development Global Trust Fund are examples of a recent shift in development assistance that has begun to target these more complex, trade-related, human development issues. In some instances, additional assistance is conditioned on demonstrable improvements in governance and rule of law. This correctly recognizes that developed countries and international institutions cannot help states that are not helping themselves.

But many poor countries that are helping themselves through honest governance need additional help in two key areas to take advantage of globalization. The first is capacity-building aid, including roads, ports, and infrastructure, which are needed to enable

Figure 1. Aid to Developing Countries^a

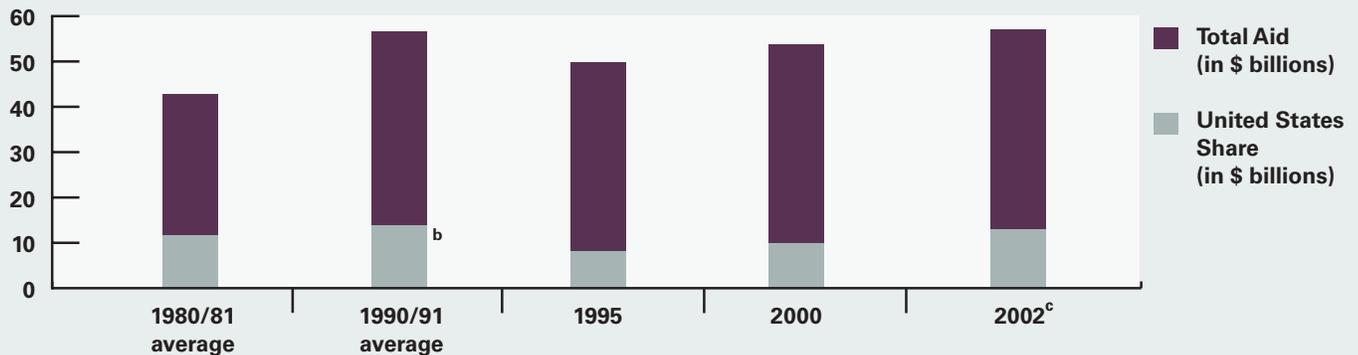
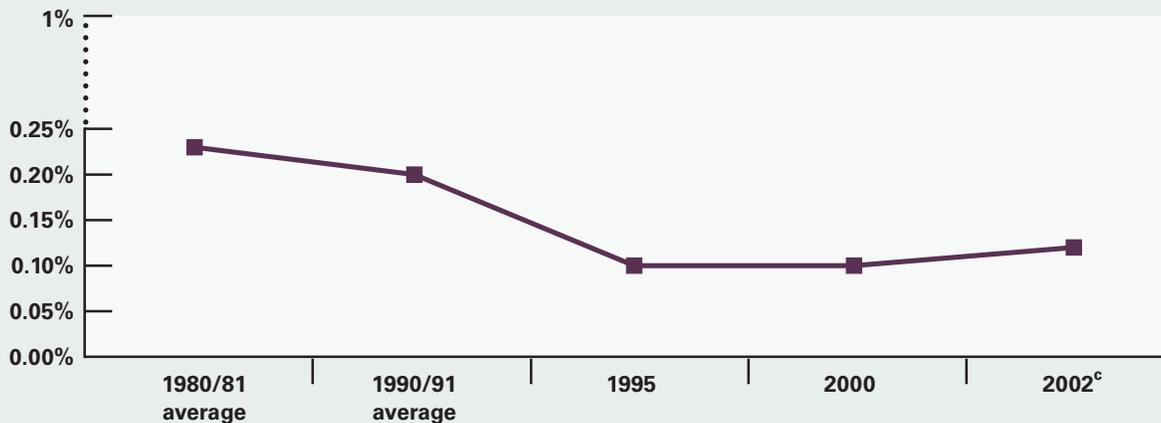


Figure 2. United States Aid as a Percent of Gross National Income



Sources: Organization for Economic Cooperation and Development (OECD), *The DAC Journal Development Co-operation 2002 Report*, 2003, Vol. 4, No. 1, and OECD, *DAC Online Database*, Table 1 "Disbursements and Commitments of Official and Private Flows," available at <http://www1.oecd.org/dac/html/online.htm>.

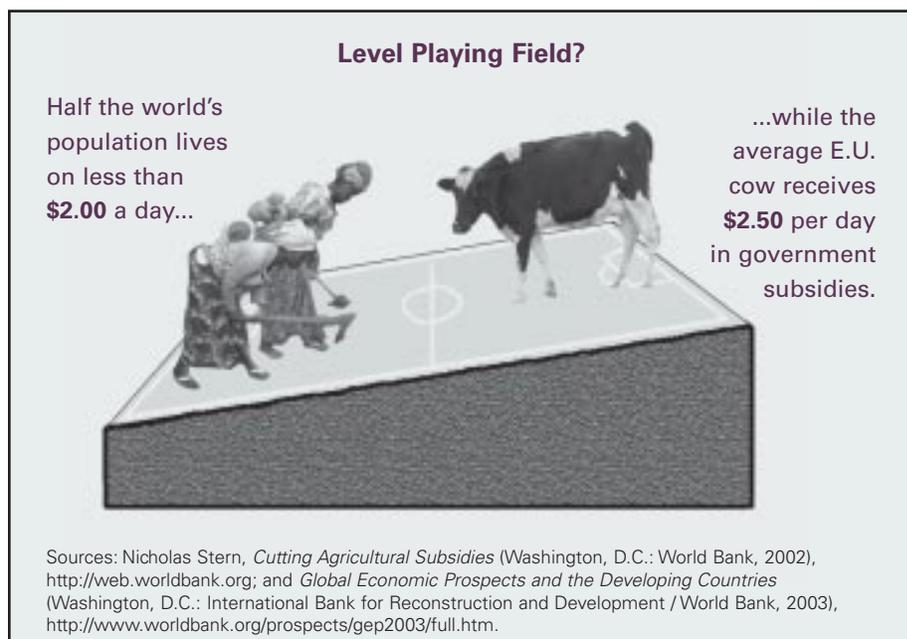
- a Official Development Assistance (ODA) measures aid to developing countries and territories. ODA's Development Assistance Committee (DAC) accounts for at least 95 percent of worldwide aid disbursements. DAC donors include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, and United States.
- b Includes debt forgiveness of non-ODA claims in 1990 and 1991 of \$1,200 million and \$1,855 million, respectively.
- c Preliminary data at current prices and exchange rates.

producers to transport their products to markets, access credit, obtain information about foreign and domestic markets, and modernize communications systems. To some extent, the new forms of development assistance target these areas. This effort should be expanded and should include assistance to build infrastructure that protects the environment and promotes public health, because prevention of environmental and public health calamities saves both lives and money.

A second type of aid—funding social safety nets—is needed to help developing countries redress casualties suffered directly from trade. Trade theory has always recognized that there will be winners and losers from trade, and the experience of rich countries bears this out. Ample public resources and strong national economies enable wealthy countries to fund trade adjustment programs such as unemployment insurance, training for workers whose industries are negatively affected, and provision for health care. Such social safety nets rarely exist in poor countries. Even in those cases where leaders have the political will, government budgets are woefully inadequate.

The U.S. government has recently recognized that its public would not support further trade liberalization without stronger safety nets for trade-related casualties. As a matter of fairness and political necessity, the Trade Act of 2002 expanded eligibility and financing for safety-net provisions, retraining, and wage and health insurance coverage for trade-dislocated workers in the United States.

If safety nets are warranted for countries as strong and stable as the United States or Japan, they are essential for countries whose economies are not dynamic enough to create sufficient new jobs for workers in transition. Even as determined a free trader as Jagdish Bhagwati recognizes that when poor countries embrace trade, they may require external aid to help the losers adjust: “Clearly then we need adjustment assistance programs to take care of these adverse effects when they arise” in countries that lack budgets to fund safety nets. Bhagwati recommends the involvement



of the international financial institutions—the IMF and the World Bank. Unfortunately, relatively little attention and fewer resources have been supplied by these institutions or by the major wealthy trading countries to design, promote, and fund effective social safety nets for trade adjustment in developing countries.

Safety nets are not the business of the WTO. In March 2003, former WTO director Michael Moore noted that trade adjustment assistance is a domestic policy issue. But while the WTO rightly claims that providing such public goods is beyond its mandate, its members from poor developing countries have signed on to trade rules that they cannot afford to implement and whose social harms they cannot afford to ameliorate. If safety nets are not the responsibility of the WTO, the resourceful champions of free trade must find other effective ways to aid developing countries in adjusting to trade liberalization.

Level Playing Field

International discussion of how to level the playing field refers to two distinct but related phenomena: equitable trade rules and fair competition. Even if the rules were changed to be fairer, the “teams” might be so mismatched that fair competition is impossible.

For example, many developing countries have only two industries that can export and thus gain from trade—agriculture and the textile and apparel industries. Agricultural trade rules are among the most distorted in the world. They tilt precipitously in favor of rich countries; the many rules that must be re-balanced in agriculture are deeply entrenched and guarded by powerful political interests in the developed world. The textile and apparel industry has operated behind tariff and quota barriers throughout its history, but now the quotas are scheduled to be eliminated at the end of 2004. This will open up competition in a sector that has significant overcapacity at the global level. Workers displaced from these jobs will have nowhere to go and will be com-

ments being turned out of office, to reversals of policy, or both. When economic livelihoods are threatened, when societies become unstable, when governments lose their credibility and authority, the security of countries, regions, and the world are put at risk.

This leads to certain imperatives for both rich and poor countries at the negotiating table:

1. All countries must recognize that trade is not an end in itself. The purpose of trade is to strengthen economies through the operation of comparative advantage. Moving as rapidly as possible to eliminate trade barriers will not be the optimal policy if developing country economies are too weak to absorb the shock of uncontrolled exposure to the rough and

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peting with displaced farmers in some cases. This concatenation of events is likely to spell development disaster for at least some poor countries. In short, even seemingly “level” rules on agricultural and apparel trade may tilt steeply against poor countries.

Why All This Matters

On its face, asking the rich and powerful to be fair toward the poor and weak seems more like charity than national self-interest. But the current economic and security situation in the world suggests that augmenting development is an economic, political, and security imperative for the international system. Increasing global economic integration has meant that economic pain in one part of the world is rapidly transmitted around the globe, through product, capital, and currency markets, as well as through tightly integrated global production and supply chains. On the political level, manifestly unfair outcomes lead to govern-

tumble global economy, or if trade rules give artificial advantage to some countries and prevent others from using what comparative advantage they have.

2. Developed country governments must exhibit real leadership within their own societies to curb self-seeking of special interests, resist mercantilism, and negotiate terms that can lead to long-term development of poor countries. Above all, this requires them to open their markets to poor countries’ agricultural and manufactured goods. But it also requires that wealthy countries and international organizations provide targeted aid to strengthen laws and institutions in poor countries, help them build the institutional capacity to respect worker’s rights, protect the environment, and promote public health—and they must hold developing countries accountable for taking these steps toward development. It also means that developed

country governments and their constituencies must allow poor countries sufficient time to phase out their own tariffs and trade barriers to achieve adjustment at tolerable cost.

3. Developing country governments have also tended to bargain for the interests of their most powerful sectors and well-connected groups, while failing to address the needs of their poorest and least powerful citizens and sectors. They need to make adjustment assistance and slower phase-outs of agricultural barriers for crops produced by poor and subsistence farmers much higher negotiating priorities. At home, they must take on the responsibility of adopting policies that help the poor move out of poverty by enacting and enforcing laws that respect labor rights and protect the environment, and by rooting out corruption. If developing countries ask for more time to transition to the global economy, granting this time makes sense only if such countries demonstrate they will use it to improve the effectiveness and accountability of their governance.

4. Developing countries should also realize that trade among themselves holds some of their best potential for growth. Some of the world's highest tariff barriers exist between developing countries, making their products too expensive to sell in one another's markets.

5. Given the wide differences among WTO members, insistence on uniform trade concessions and commitments by all parties makes neither economic nor development sense. The speed and order of liberalization should reflect country-specific conditions and seek optimal outcomes for the greatest number. The Doha round wisely recognizes that least developed countries need special and differential treatment, but much more attention and accommodation are needed. The sequencing of trade liberalization should draw on hard-learned lessons from countries that have had demonstrable successes—or failures—in linking to the global economy. In

general, a gradualist approach should be the norm, not shock therapy.

6. Beyond trade institutions, other global actors must do more and do it better if the Doha round is to lead to long-lasting development for poor countries. The WTO, the World Bank, the United Nations Development Program, and the IMF recently extolled the virtues of coherence in their policy making and policy advice. But there is little evidence that the Bretton Woods institutions coordinate country lending and structural adjustment programs with trade capacity building. To facilitate development and sustainable global growth, they must also help deploy safety nets and trade adjustment assistance.

Trade negotiations at Cancun and beyond will build a global trading system that truly promotes development only if negotiators recognize the reality behind the familiar, facile phrases: seemingly level playing fields may still be steeply tilted; comparative advantage may not exist; and trade is not a substitute for aid—both are often essential. Knowing that the promises implied in these phrases are often not delivered should prompt the stewards of the international political economy to agree to trade rules and assistance that enable poor countries to benefit from global trade. Only then can negotiations that deserve the name “development round” make progress. Until then, the promise of benefits from liberalized trade will be a hollow one for billions of the world's people. Likewise, rich governments can expect repeats of the Seattle debacle and the false start at Doha. ■

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