

Think Again: International Trade

Arvind Panagariya

November/December 2003

Why have disagreements between rich and poor nations stalled the global trading system? Because vapid debates over “fair trade” obscure some inconvenient facts: First, notwithstanding their demands for equity, poor countries are more protectionist than advanced economies. Second, if rich nations cut their self-defeating agricultural subsidies, their own publics would benefit, but consumers in many poor countries would not. Finally, despite criticisms to the contrary, the WTO can help promote economic development in low-income countries—but only if rich nations let the global body do its job.

“Economies That Are Open to Trade Grow Faster”

True. In low-income countries, openness to international trade is indispensable for rapid economic growth. Indeed, few developing nations have grown rapidly over time without simultaneous increases in both exports and imports, and virtually all developing countries that have grown rapidly have done so under open trade policies or declining trade protection. India and China are the best recent examples of countries that started with relatively closed trade policy regimes in the 1980s but subsequently achieved accelerating growth while opening up their economies. From the mid-1950s through the mid-1970s, industrial countries also enjoyed rapid growth while dismantling their high post-World War II trade barriers and embracing new technologies. Japan offers the most dramatic example, but countries such as Denmark, France, Greece, Italy, the Netherlands, Norway, and Portugal exhibited similar patterns.

Openness to trade promotes growth in a variety of ways. Entrepreneurs are forced to become increasingly efficient since they must compete against the best in the world to survive. Openness also affords access to the best technology and allows countries to specialize in what they do best rather than produce everything on their own. The fall of the Soviet Union was in no small measure due to its failure to access cutting-edge technologies, compete against world-class producers, and specialize in production. Even as large an economy as the United States today specializes heavily in services, which account for 80 percent of total U.S. output.

Of course, openness to trade is not by itself sufficient to promote growth—macroeconomic and political stability and other policies are needed as well—so some countries have opened up their markets and still not seen commensurate increases in economic growth. That has been particularly true of African countries such as the Ivory Coast during the 1980s and 1990s. But such instances hardly disprove the benefits of openness. Economists do not understand the process of growth well enough to predict precisely when the opportunity will knock on a country’s door. But when it does knock, an open economy is more likely to seize it, whereas a closed one will miss it. Even globalization skeptics such as economists Dani Rodrik and Joseph Stiglitz recognize this point; neither chooses trade protection over freer trade.

“Rich Countries Are More Protectionist Than Poor Ones”

Not even close. On average, poor countries have higher tariff barriers than high-income countries. For instance, rich nations' tariffs on industrial products average about 3 percent, compared to 13 percent for poor countries. Even in the textiles and clothing sectors, tariffs in developing nations (21 percent) are more than double those in rich countries (8 percent, on average). And while textiles and clothing are subject to import quotas in rich economies, such restrictions are due to be dismantled entirely by January 1, 2005, under existing World Trade Organization (WTO) agreements.

Of course, not all poor countries are equally protectionist; some are even more open to trade than rich nations. For many years now, Singapore and Hong Kong have been textbook cases of free-trading nations. Likewise, middle-income economies such as South Korea and Taiwan are not significantly more protectionist than developed countries. But overall, the countries that stand to benefit most from greater competition and openness are those nations that display the highest protection, including most countries in South Asia and some in Africa.

The highest tariffs—or “tariff peaks”—in rich countries apply with particular strength to labor-intensive products exported by developing countries. In Canada, the United States, the European Union (EU), and Japan, product categories with especially high tariff rates include textiles and clothing as well as leather, rubber, footwear, and travel goods. But developing countries themselves are often quite zealous in protecting their markets from goods exported by other poor nations. Labor-intensive products such as textiles, clothing, leather, and footwear, which developing countries also export to each other, attract high duties in countries such as Brazil, Mexico, China, India, Malaysia, and Thailand.

Traditionally, rich economies such as the United States and the EU have been quick to engage in antidumping initiatives—erecting trade barriers against countries that allegedly export goods (or “dump” them) at a price below their own cost of production, however difficult it may be to quantify such a charge. But developing countries have been learning the same tricks and initiating antidumping measures of their own, and now the number of such actions has converged between advanced and poor economies. For example, according to the “WTO Annual Report 2003,” India now ranks first in the world in initiating new antidumping actions, and third (behind the United States and the EU) in the number of such actions currently in force.

“Freer Trade Increases Poverty in the Third World”

Not true. Historically, countries that have achieved large reductions in poverty are generally those that have experienced rapid economic growth spurred in significant measure by openness to international trade. Newly industrialized economies such as Hong Kong, Singapore, South Korea, and Taiwan have all been open to trade during the past four decades and have been entirely free of poverty, according to the dollar-a-day poverty line, for more than a decade. By contrast, during the 1960s and 1970s, India remained closed to trade, grew approximately 1 percent annually (in per capita terms), and experienced no reduction in poverty during that period.

Trade helps produce rapid growth, and rapid growth helps the poor through three channels. First, it leads to what Columbia University economist Jagdish Bhagwati calls the active “pull-up” rather than the passive “trickle-down” effect—sustained growth rapidly absorbs the poor into gainful employment. Second, rapidly growing economies can generate vast fiscal resources that can be used for targeted anti-poverty programs. And finally, growth that helps raise incomes of poor families improves their ability to access public services such as education and health.

The current impression that the freeing of trade has failed the world's poor is partially rooted in disputable “official” World Bank poverty figures. The bank reports that though the proportion of the poor in developing countries declined from 28.3 percent in 1987 to 23.2 percent in 1999, increased population has left the absolute number of poor unchanged at 1.2

billion. And since that period also witnessed further freeing of trade, some conclude that trade has failed the poor. Yet, independent research by economists Surjit Bhalla in New Delhi and Xavier Sala-i-Martin at Columbia University has persuasively shown that the absolute number of poor declined during 1987–99 by at least 50 million and possibly by much more.

“Agricultural Protectionism in Rich Nations Worsens Global Poverty”

Not necessarily. If developed countries eliminate all forms of agricultural protection, including subsidies to domestic producers and quotas on foreign imports, their agricultural production will decline and the worldwide price of agricultural products will increase. Therefore, poor countries that are efficient agricultural producers will benefit from higher prices and access to new export markets. But consider the flip side: Poor countries that import agricultural products will suffer from higher prices. In 1999, as many as 45 of the 49 least developed countries imported more food than they exported. In 2001, for example, Senegal spent as much as \$450 million on food imports, equivalent to about 10 percent of its gross domestic product and one third of its annual export earnings. Certainly, if agricultural trade is liberalized and prices rise, some poor countries will become net agricultural exporters, but many will not.

Some may argue that even if the poor countries pay higher prices for agricultural imports, their poor farmers will still benefit from those increased prices. But, in fact, high domestic prices do not require high world prices. Even under current world trading rules, the least developed countries can offer higher than world prices to their own farmers. In India, for example, the government buys food grains from farmers at prices higher than (and unrelated to) world agricultural prices.

Ironically, the major beneficiaries of widespread agricultural liberalization would be rich countries themselves, which bear the bulk of the cost of the subsidies and protection, and their domestic consumers. Other potential beneficiaries include nations such as those belonging to the Cairns Group—a coalition of 17 agriculture-exporting countries (9 of them from Latin America but also including advanced economies such as Canada and Australia) that enjoy efficient agricultural sectors and lobby for more open trade in agriculture.

Ultimately, even if some poor countries did suffer from more open agricultural trade, the case for liberalizing global agricultural markets remains unimpeachable. The current trading system in agriculture grossly distorts prices and production patterns and results in an inefficient global agricultural market.

“Poor Countries Should Not Open Their Markets If Rich Countries Maintain High Trade Barriers”

Big mistake. As the late British economist Joan Robinson once remarked, “if your trading partner throws rocks into his harbor, that is no reason to throw rocks into your own.” Responding to protectionism with more protectionism may seem “fair,” but it is downright silly. Many Western advocacy organizations and religious groups that make this argument fail to understand that such talk hardly helps poor nations. It is hard enough for leaders in these countries to convince domestic producers that opening national markets is a worthy objective; loose talk of “hypocrisy” and “unfairness” only makes it harder. Even people who should know better fall into this trap. “It is surely hypocritical of rich countries to encourage poor nations to liberalize trade,” former World Bank chief economist Nicholas Stern reportedly stated in a March 2001 speech in New Delhi, “whilst at the same time succumbing to powerful groups in their own countries that seek to perpetuate narrow self-interest.”

Certainly, trade protectionism by rich nations merits opposition. But whether or not rich nations lower their barriers, poor countries should unilaterally dismantle their own protectionist policies in order to increase trade and stimulate economic growth. Trade barriers are often porous rather than absolute, so that countries with outward-oriented policies often succeed in expanding exports even when markets in partner nations are not fully open. Trade-

oriented East Asian economies such as Hong Kong, Singapore, South Korea, and Taiwan have registered excellent export performance since the early 1960s. By contrast, relatively protectionist countries such as India, China, Argentina, and Egypt have hurt their own export growth and, as a result, stifled their overall economic performance in those years. Yet all these countries faced virtually the same trade protectionism abroad. Economic history since the end of World War II confirms that export pessimism is self-fulfilling, whereas nations that adopt export-oriented trade policies manage to exploit international markets despite foreign protectionism.

“There Is No ‘Development’ in the Doha Development Agenda”

False. Judging by the anger many poor nations displayed at the recent WTO talks in Cancún, it would seem that the current round of WTO trade negotiations—ambitiously dubbed the “development round” when the talks were launched in Doha, Qatar, in late 2001—have nothing to offer the cause of development. But such a conclusion would be mistaken. Insofar as the WTO negotiations aim to liberalize trade in nations both rich and poor, development cannot and will not be missing from the agenda.

For more than four decades, developing countries have demanded that rich economies remove their tariff peaks, which apply in particular to labor-intensive goods (such as textiles, apparel, and footwear) from developing countries. The Doha declaration explicitly addressed this objective. The declaration also addressed the substantial relaxation of agricultural protection in rich nations, including the removal of farm subsidies, which developing nations consider crucial. Brinkmanship by both rich and poor countries produced the failure in Cancún, but the negotiations are far from buried. When they eventually conclude, development concerns will be central to the agreement.

However, even well-intentioned advocates can go too far in linking trade policy with development. Former WTO Director-General Michael Moore has argued that investment and competition policy, transparency in government procurement, and trade facilitation (i.e., less red tape when goods enter a country and adequate information on import and export regulations) are also development issues. The EU has placed these issues on the Doha agenda, even though a large number of developing countries oppose their inclusion.

The expansion of the WTO into these areas contributed in no small measure to the breakdown of talks in Cancún. Agreement in these areas would require developing countries to adopt existing developed-country practices and regulations; this action would therefore impose “asymmetric” obligations on developing countries. Many poor countries lack even the resources necessary to implement these obligations. Finally, differences in local conditions require local solutions rather than an externally imposed and globally uniform regime in these areas. “One size fits all” is the wrong answer.

“The World Trade Organization Harms Poor Countries”

No. Contrary to popular belief among many Western nongovernmental organizations and politicians in developing countries, the WTO is the best friend available to exporters in poor nations. The General Agreement on Tariffs and Trade (GATT), signed in 1947 and incorporated into the WTO at the latter’s inception in 1995, substantially opened markets in rich countries during the first 40 years of the GATT’s existence. Under its “most favored nation” provision, GATT required that such markets be open to all GATT members, including developing countries. Therefore, even without undertaking any trade liberalization of their own, developing nations became the beneficiaries of the market opening in the developed world.

The GATT’s Uruguay Round of trade negotiations, which began in 1986 and culminated in the establishment of the WTO, marked the first time rich nations insisted that developing countries fully participate in the negotiations. Developing countries felt shortchanged in this round on three counts: Their expectations of opening agricultural markets in rich countries were not

realized; developing countries committed themselves to cutting industrial tariffs more deeply than developed economies; and developed countries successfully enacted a global intellectual property rights regime that undermined poor countries' access to cheap medicines.

Although the Uruguay Round benefited developed countries more than developing ones, poor nations still gained. First, developing countries liberalized more because they had higher trade barriers to begin with (and remember, in economic terms, greater liberalization is a benefit, not a cost). Second, after years of complaining, developing countries convinced developed nations to commit to dismantling quotas on imports of textiles and clothing. Third, while the Uruguay Round did not enhance developing countries' access to global agricultural markets, it opened the way for future liberalization in this important arena.

Despite the dominance of developed countries and skewed distribution of the bargaining power within the WTO, the global body offers low- and middle-income countries a rules-based forum in which to defend their trading interests and rights. For example, the strength of the WTO has helped developing nations deflect pressures from rich nations to link further trade opening to the creation of stronger labor standards in poor nations. Without the WTO, developed countries simply could have resorted to unilateral trade sanctions to enforce their desired standards. Moreover, at the September 2003 trade talks in Cancún, this rules-based bargaining allowed developing countries to delay negotiations on investment and competition policy.

"Free Trade Is Bad For the Environment"

No. Certainly, trade forces can hurt the global environment. For instance, the rapid expansion of coastal shrimp farming in several countries in Asia and Latin America in the 1980s, driven principally by the demand for exports, led to the contamination of water supplies and destruction of surrounding mangrove forests. But trade opening can bring environmental benefits as well. For example, the agricultural liberalization proposed in the WTO's Doha negotiations would not only bring economic and efficiency benefits by shifting production from high-cost to low-cost producers, but it would also yield environmental benefits by replacing Europe's pesticide-intensive agriculture with natural manure-intensive agriculture in developing countries.

Activists who decry the environmental impact of trade should realize that trade protectionism often brings environmental costs as well. During the 1980s, the United States imposed quotas on Japanese small-car imports; the policy not only hurt U.S. consumers but also harmed the environment by reducing access to lower-pollution vehicles. More broadly, closed-door policies in pre-1989 Eastern Europe were accompanied by an extremely poor environmental record.

When trade produces adverse environmental effects, the solution is not to ban or restrict trade. Instead, governments should adopt appropriate environmental policies to achieve environmental objectives and allow trade policy to target economic objectives. In the shrimp farming case, shrimp producers should be taxed for the pollution they create but then left to trade freely. Such a policy normally will reduce exports and economic output, but that result would be offset by reduced pollution. Reliance on a single instrument (trade policy) to target both economic and environmental objectives is like trying to kill two birds with one stone—a strategy successful hunters would not recommend. Just as governments should not subsidize trade to help the environment, neither should they restrict it to avoid harming the environment.

Arvind Panagariya is professor of economics and codirector of the Center for International Economics at the University of Maryland, College Park. He is coauthor of Lectures on International Trade (Cambridge: MIT Press, 1998) with Jagdish Bhagwati and T.N. Srinivasan.