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## After Cancun: the future of free trade

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**Abstract :** Globalization – and anti-globalization – have been at the center of discussions of international economic relations for the last 15 years. But a new North-South axis has recently emerged in the wake of the failed Cancun summit that goes to the heart of the current debate over the future of the free trade system that has defined the international environment for over a half-century. Agriculture is central, an ironic twist in view of the continuing much greater growth of industrial products. At the same time, multilateralism seemingly has yielded to a new surge of bilateralism. What will be the future of free trade, and with what consequences for the process of economic development ?

# After Cancun: the future of free trade

Albert Fishlow

**G**lobalization, and anti-globalization, are much at the center of current economic policy around the world. They recur in many guises and extend to many additional areas. Anthony Giddens, the author of *Runaway world : How globalisation is reshaping our lives*, put it succinctly : « Globalisation is political, technological and cultural, as well as economic. »

Yet it is well to note that this is not the first time that globalization has surged. The second half of the nineteenth century up through the First World War saw a previous marked expansion of international trade and foreign investment, that peaked shortly before 1914. Reduced transportation cost – internal as well as external – was an important contributory factor, as was the immense flow of migration and monetary stability imposed by the spread of the gold standard.

The War itself, and the successor 1920s, soon reversed that integration and brought to an end the equilibrating role of the gold standard. Thereafter the Great Depression saw considerable declines in global output, trade and commodity prices. The primary task after 1945 was to restore international rules and promote the recovery of Europe and Asia ; key factors were the conflict with the Soviet Union and the consequent Marshall Plan. A major role was played by open access to the United States market.

From the 1950's on, rising international trade was an essential component. This time, differently from before, it was concentrated among the developed countries and focused upon expanded exchange of manufactures. Prices of primary products, while temporarily enhanced by the Korean War, soon retreated. That made the Prebisch alternative of import-substituting industrialization seem attractive to many developing countries. Alas, it led many of them to miss out upon earlier, and potentially more advantageous entry into a global market.

Over the last half-century, the percentage change of international trade relative to that of world domestic product has been almost double. Not only have economies opened in successive rounds of the GATT, but also international finance has come to the fore, slowly at first, but with progressive force. In recent decades the expansion of capital markets has been logistic, what with instantaneous electronic access. And one has begun to see still more new entries into the ranks of the developed economies. This has occurred in eastern Europe, and recently been recognized by the expansion of the European Union ; and it has occurred within Asia, with the rise of the followers to Japan, notably the four geese. South Korea, Taiwan, Singapore and Hong Kong.

Such a broad subject as globalization requires volumes – of which there have been many, and some would even say, too many. Google, as an aside, shows some 2.5 million items, up from the 1.5 million entries Stanley Fischer mentioned just a year ago. Today, as a result, I prefer to limit myself to three central issues.

The first of these is the question of the future of international trade. Will the past pattern of advance continue, as in the past, or will a new burgeoning hostility assert itself in international markets, as it already has within countries ?

A second, and related, matter are the consequences of greater international integration upon domestic growth performance. Does expansion of trade contribute to higher levels of domestic product, and in what way ?

And finally, what domestic policies are necessary to assure that poverty and unequal distributions of income in developing countries are alleviated by greater participation in the world economy ? Volatility of exchange rates, foreign investment, commodity prices, and the volume of trade has been sufficient to unsettle many developing economies in recent years.

## International trade

The extent of progress in dismantling barriers to trade in the post World War period is impressive. From earlier bilateral negotiation that became generalized through the most favored nation principle, the process evolved, under GATT, into large multilateral undertakings. The Kennedy, Tokyo and Uruguay Rounds saw significant advances in a number of additional dimensions beyond reductions in tariffs and reliance upon non-tariff barriers.

First, there was the greater participation of developing countries as active participants. What had started out as a process involving primarily the United States, and the recovering industrial countries, broadened into a multitude of nations. Originally, there were only a few dozen participants. At last count, membership incorporated more than 150 countries. Not that their concerns have always mattered : initially it was left for UNCTAD to publicize and expound their special interests. Not until the Doha Round, which was to be a « development round », and after the demonstration that trade expansion was very much a necessary condition for developing country growth, did the process fully change.

Second, there has been continuing extension of rules involving new areas : the alphabetical listings sometimes boggle the mind. There are the GATS, involving services ; TRIMs, involving investment ; TRIPs, involving intellectual property rights, as well as TPRM, the trade policy review mechanism. These have evolved unevenly, and arguably to the benefit of the developed countries. This helps to explain, I believe, some of the response by the developing countries recently in

Cancun. Even under the pressure of a horrific AIDs epidemic, not to mention a resurgence of malaria and tuberculosis, it took enormous effort to modify TRIPs to allow exchange of pharmaceuticals among developing countries.

Third, there has been a simultaneous process of bilateralism and regionalism that has sprouted to the side of this advancing multilateralism. In part this was the consequence of slow progress in the Uruguay Round – it took a decade to complete – and in part, to the political interests of the developed economies. So sprang up the possibility of APEC in the Pacific and FTAA in the Western Hemisphere. The EU, has, of course expanded and consolidated, most recently with its extension eastward. Much of the literature surrounding trade in recent years is related to the consistency of such bilateralism and regionalism with the objectives of global agreement.

These changes, and the dramatic failure at Seattle, led up to the Doha Round. It is fair to say that developing countries achieved major recognition there, with the objective of enabling a greater share of gains than they had previously derived. Coming as well after 11 September, the United States was prepared to allow more contentious items on the agenda than it had previously done in order to assure the success of the meeting.

Then came Cancun, and the last minute attempt by the United States and the EU essentially to take the subject of agricultural subsidies – coming to something of an order of \$1 billion a day – off the agenda. After all, the Uruguay Round had only been able to try to limit their magnitude, with the expectation that a future meeting would deal with the subject more thoroughly. This led to the formation of the G-20 by Brazil, and other major countries such as China, India, South Africa, and several others. When additionally, the EU sought to place the four Singapore Issues on the agenda, consisting of Investment, Competition Policy, Transparency in Government Procurement and Trade Facilitation – which required explicit consensus according to Doha, the meeting rapidly came to an end before any compromise on agricultural issues could be struck.

Now, after rounds of further international visits and discussions, another key date emerges, the end of July. This time, there is greater probability of success. The EU, despite French opposition, has already proposed a \$4 billion reduction in support for beef, wheat and milk powder. It has likewise shown a disposition to be much less insistent upon the whole of the Singapore Issues. The United States, returning to its pre-Cancun position in favor of reducing subsidies to agricultural exports, seemingly is much closer to the G-20 position.

There is a certain irony here, in the immense attention dedicated to agriculture. To be sure, it is an area where some developing countries, having incorporated advanced technology and with consequent productivity gains, stand very much to benefit. But others, and in recent data, as many as 45 of the 49 least developed countries imported more food than they exported, will face

rising prices for these imports. After all, that is what subsidies are all about. There will be better allocation of resources in the end, as the price rise redistributes production worldwide. But the demand for agricultural products inherently faces a low income elasticity. It cannot be the basis for successful integration in a 21st century world, much as it can afford an initial boost. That is precisely the difference between the last great cycle of globalization at the end of the nineteenth and beginning of the twentieth century. Then, successful developing countries exported primary products ; now it is manufactures.

Clearly, the prospect of getting Doha on track again is extraordinarily positive. Research undertaken by the World Bank shows that developing countries could this time reap income gains of more than \$500 billion (in 1997 dollars), or something like 5 % of their current income levels, assuming a full reallocation of productive structures. Especially to be noted is that the benefits to the developed countries fall far short of this level, both in absolute value – \$300 billion – as well as percentage -1 %. Finally, the multiplier effect of the static trade gains are palpably larger in the developing countries. So globalization still has much to offer, and not exclusively one should add, for the developed countries.

### Three brief additional conclusions should be noted

The World Trade Organization has made impressive progress. In particular, its advancing process of determining the rules under which trade should occur has been impressive. The developed countries no longer have the freedom they did previously to invoke voluntary export restraints and other mechanisms to ease the process of eventual adaptation. Now judicial decisions from the WTO are accelerating that process. And as a consequence, shares of employment within manufacturing have shrunk in the advanced countries as those in the developing world advance.

That process has translated into a more vigorous participation by developing countries in international trade. Despite the rhetoric, the reality is one of rising shares of exports relative to gross domestic product. At a global level, merchandise increased from 10 % in 1973 to something like double that level currently. For developing countries, their share in exports has increased from a quarter to a third. Integration has become a reality. The earlier appeal of import substitution and dependency theory have significantly been eroded over the last decades. Privatization has been a major tendency, and on the whole, has yielded better results.

And finally, a major contribution can be made in disciplining the immense spaghetti bowl of bilateral and regional trade agreements. That way is through the commitment to multilateralism. Alternatives were sought as the time required to reach broader agreement seemed to stretch ever

longer. Regionalism seemed a way forward that many argued could be compatible with eventual more general arrangements. But increasingly regionalism seems to lurk as an alternative. By embedding arrangements that are at variance with the WTO, moreover, they become a source of pressure upon countries eager to ally with the three large units : the US, EU and Japan. In recent years, we have seen too little accommodation among the macroeconomic and exchange rate policy of these principals. Establishing institutional mechanisms for their continuity can become negative rather than a productive, intermediate stage on the road to trade liberalism.

## Trade, growth and inequality

Over the last two decades, considerable gain has occurred in the technical treatment of these three interrelated subjects. For one, simplicity has been ruled out. No one any longer, if they ever did initially, believes that commitment to trade inevitably produces higher income and, thereby, a better distribution of income. But there is persuasive evidence that greater openness is a necessary, if not sufficient, cause of higher rates of growth. The World Bank has been arguing this from the 1980s on, and even earlier studies of a variety of countries has tended to make the point.

Sachs and Warner demonstrate not merely that more open countries grow more rapidly, as had been argued previously, but that they do so, holding a variety of other causal elements constant. Not everyone concurs : Dani Rodrik, for one, has been insistent in asserting that other causal factors are more basic. But even he would see freer trade as a positive factor, provided the countries in question had undertaken a variety of complementary efforts first (or simultaneously) – as we shall discuss in our next section. As he puts it, « The trick in the successful cases has been to combine the opportunities offered by world markets with a domestic investment and institution-building strategy to stimulate the animal spirits of domestic entrepreneurs. » There have been countries that have opened, but seen little positive consequence. Africa is a source of many early examples. And on the other side, great successes like East Asia, China and India over the last fifteen years have done so more gradually, building upon expansion of exports to open domestic markets more gradually.

More recently, there is some evidence that gains from openness to trade have diminished in the 1990s relative to the success that was achieved in earlier decades. That may, however, be precisely the consequence of broader entry of developing countries, and the process of global learning that has occurred. That still would not alter that there is a net advantage to be gained, whose magnitude ultimately depends upon the capacity to scale the ladder of comparative advantage.

Necessarily, policies must be individual and geared to particular circumstances, but at the end of the day, it would be unfortunate if developing countries did not seek to expand their position in international markets. That is quite consistent with the call for greater South-South interchange, provided it avoids a process of differential protection that is sometimes urged.

The second part of the story is the interrelationship of growth and inequality. On this issue there is likewise no lack of scholarly contributions over the last decades, nor of different opinions. One has come some way from Simon Kuznets' early finding of a parabolic relationship between growth and inequality, whereby it would initially rise as an initially agricultural labor force turned to industry. (And, as elsewhere, there are divisions over its validity.) Where one now stands is that growth is very much a necessity to reduce poverty, but that inequality seems to resist large positive improvement.

Some studies do show a positive change in the lowest quintile of the income distribution of the same proportion to aggregate income growth for countries that are open to trade. Others maintain that the effects move in the opposite direction as gains are preserved by capitalists and losses show up in unemployment and adverse movements in the terms of trade.

If there is some question about income distribution consequences, there is virtually none when it comes to measurement of poverty. There is good evidence that expanding income in Asia has had the effect of reducing poverty there decisively. That can hardly be surprising in view of the growth over the last decade of China at a rate exceeding 9 % and India at more than 6 %. The percentage of the population receiving less than \$1 a day fell dramatically, as it did in other countries within the region. The same cannot be said for Africa and Latin America. There, both absolute numbers as well as the proportion of the population scaled as poor have moved upward since 1990. That helps to explain some of the recent, and unfortunate, political consequences in both continents.

So there appears to be a clear relationship spreading from expanded trade to higher growth to improvement in poverty, if not necessarily in income distribution. Why then the resistance so frequently encountered ? In the next section, we take up the need for domestic policies to compensate some of the consequences of greater openness, and especially the necessity for more attention to the need for investment in human capital.

## Domestic policy necessities

One can open trade in the short term, but gaining full advantage of that potential opportunity are more likely to involve longer term adaptations.

High among the requirements in many developing countries is a need for educational reform. Gains are already observable in recent years. But there is still much to go. In the low and middle income countries, there has been impressive gain over the last 20 years : the net enrollment rate at the level of primary school now exceeds 90 %, and secondary attendance comes to something approaching 70 %. But problems remain. For one there is the fact of repetition ; for a second, there is the reality of limited quality, particularly within rural areas ; and for a third, there is the disproportion of expenditure at the University versus the primary level. Treating these issues will increase the productivity of what has been rising expenditure.

Additionally, there is the field of health outlays. Fortunately, there has been a significant reduction in fertility rates and child mortality rates over the last decades in developing countries. As the population shifts from rural to urban settings, further gains will occur. Such a change permits one to benefit from an increase in the proportion of the population in the labor force. This benefit will be later countered by movement in the other direction as the age structure of the population alters, but over the next decades there is scope to benefit.

These gains go along with the expected rise in mortality rates deriving from AIDs, especially in Africa. These impact not merely the young, but also those in the labor force. Their consequences are potentially disastrous, and are rightly a cause of serious concern. There has been progress made in amending the initial code of intellectual property rights to permit sales of pharmaceuticals at lower cost, and some countries have begun to respond favorably.

If such an emphasis can be sustained on the use side of the public accounts – despite the pressures for macroeconomic stability – there is equivalent need on the source side. To be specific, savings rates within much of the developing world have not responded as one would have hoped. The Asian success is countered by the limited advance elsewhere. That has meant high real interest rates and a flurry of debt problems in Latin America over the last five years.

Low savings rates are invitations for a greater role for foreign investment than it ought to have, especially when the commitment is financial rather than physical. Volatility of exchange rates, and output, necessarily follow. Latin America is a special case : the measured savings rate is just about what it was more than 40 years ago. There clearly is a positive role for direct foreign investment as a mechanism for transfer of new and more productive technology in a variety of sectors. Where would we be in the new computerized economy without the inputs from the Asian economies ? That is precisely the other side of globalization : the opportunity for new comparative advantage to transform production.

One way to manage the volatility of external capital flow – and it is a historical rather than recent phenomenon, as anyone familiar with nineteenth century foreign investment will relate – is by direct limitation of inflows from abroad. The cases of Chile and Malaysia are frequently cited as

positive examples. Yet the reality of each was temporary rather than permanent controls, and high domestic savings rates that enabled such controls to be effective without imposing domestic crisis. Or when it came in the Asian economies in 1997, as it did, domestic savings underwrote rapid recovery and much lower interest rates.

Increased savings can originate not merely from private sources, but also from public. In many of the countries that have mounted large efforts to produce primary surpluses – but still retain deficits owing to outlays for interest payments – there is precisely an opportunity to convert lower interest rates into greater surpluses. Private sectors will soon respond as profitable opportunities for application of resources appear.

What is important in all of this is precisely the necessary sequencing. Globalization reflects an opportunity, not an automatic realization. That is precisely why it so important to give emphasis to domestic policy choice in discussion of the ways one can take advantage of the changes that have occurred over the last several decades.

## Conclusion

One of the major, and valid, reasons for the opposition to globalization is the fear that such liberalization will prevent important steps in the direction of social progress within the developing countries. Opening to trade is made equivalent to neglect of the continued, and large, number of poor that inhabit the earth. That by no means follows, however.

Globalization requires effective macroeconomic policies – except perhaps in the United States where twin deficits have now recurred. That is one of the reasons why world inflation rates have declined so over the last twenty years. But such policies do not translate automatically into corresponding neglect of the less advantaged. There is both opportunity, and indeed, necessity to undertake domestic reforms that are vital to economic growth. Commitments to advances in education, health, housing, and urbanization are required if growth is to prove sustainable. Globalization is a means rather than an end. Would that politicians from the Left grasp that reality, and take full advantage of the opportunity they have to establish continuity of domestic policy. Inevitably it takes time.

At the end of the day, such responses will bring the possibility of continuing gains in productivity. And that productivity growth, even in the case of the United States, derives something like 80 % from technological progress and only 20 % from greater international trade. And that for a country that has seen its ratio of exports to product doubling over the last thirty years.

Those productivity gains are essential for providing the continuous real investment required to accomplish the convergence in world income levels that has been so much lacking in previous decades. Hopefully, it will not be the developed countries that prevent this evolution from occurring.