

# Two Principles for the Next Round

## Or, How to Bring Developing Countries in from the Cold

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In all likelihood, the WTO Ministerial this November will usher in a new Round of negotiations, the ninth in a series that began in Geneva in 1947. I am delighted that Mr. Moore has called on WTO members to provide more help to developing countries, and gone so far as to describe these negotiations as a “development round.” Today, I want to reinforce Mr. Moore’s call. I will argue that basic notions of equity and a sense of fair play require that the next round of trade negotiations be more balanced—that is, more reflective of the interests and concerns of the developing world—than has been the case in earlier Rounds. I would go even further than this and say that unless we achieve greater balance, we will place at peril the success of future trade negotiations.

The stakes are high. There is a growing gap between the developed and the less developed countries, highlighted in this year’s World Development Report (see Graph 1).<sup>1</sup> The international community is doing too little to narrow this gap: even as the ability of developing countries to use aid effectively has increased,<sup>2</sup> the level of development assistance has

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<sup>1</sup> World Bank (1999).

<sup>2</sup> The World Bank’s recent study *Assessing Aid* (World Bank 1998) shows that in countries that have put into place the right policies and institutions, aid can be very effective in increasing economic growth and in reducing poverty.

diminished, with aid per capita to the developing world falling by nearly a third in the 1990s.<sup>3</sup> Too often, the cuts in aid budgets have been accompanied by the slogan of “Trade, not aid,” together with exhortations for the developing world to participate fully in the global marketplace. Developing countries have been lectured about how government subsidies and protectionism distort prices and impede growth. But all too often there is a hollow ring to these exhortations. As developing countries do take steps to open their economies and expand their exports, in too many sectors they find themselves confronting significant trade barriers—leaving them, in effect, with neither aid nor trade. They quickly run up against dumping duties, when no economist would say they are really engaged in dumping, or they face protected or restricted markets in their areas of natural comparative advantage, like agriculture or textiles.

In these circumstances, it is not surprising that critics of liberalization within the developing world quickly raise cries of hypocrisy. Developing countries often face great pressure to liberalize quickly. When they raise concerns about job loss, they receive the doctrinaire reply that markets create jobs, and that the resources released from the protected sector can be redeployed productively elsewhere. But all too often, the jobs do not appear quickly enough for those who have been displaced; and all too often, the displaced workers have no resources to buffer themselves, nor is there a public safety net to catch them as they fall. These are genuine concerns. What are developing countries to make of the rhetoric in favor of rapid liberalization, when rich countries—countries with full employment and strong safety nets—argue that they need to impose protective measures to help those adversely affected by trade? Or when rich countries play down the political pressures within developing countries—

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<sup>3</sup> The figure was US\$32.27 in aid per developing-country resident in 1990, but only US\$22.41 in 1997 (World Bank Statistical Information and Management Analysis database).

insisting that their polities “face up to the hard choices”—but at the same time excuse their own trade barriers and agricultural subsidies by citing “political pressures”?

Let me be clear: there is no doubt in my mind that trade liberalization will be of benefit to the developing countries, and to the world more generally. But trade liberalization must be balanced, and it must reflect the concerns of the developing world. It must be balanced in agenda, process, and outcomes. It must take in not only those sectors in which developed countries have a comparative advantage, like financial services, but also those in which developing countries have a special interest, like agriculture and construction services. It must not only include intellectual property protections of interest to the developed countries, but also address issues of current or potential concern for developing countries, such as property rights for knowledge embedded in traditional medicines, or the pricing of pharmaceuticals in developing-country markets.

Trade liberalization must take into account the marked disadvantage that developing countries have in participating meaningfully in negotiations. For instance, as the new World Development Report points out, 19 of the 42 African WTO members have no trade representative at WTO headquarters in Geneva. In contrast, the average number of trade officials from OECD countries is just under seven.

In approaching the upcoming negotiations, moreover, we must look at them not in isolation, but in a historical context. We need to address suspicions born of a legacy of past power imbalances.

Moreover, we must recognize the differences in circumstances between developed and developing countries, differences to which I have already alluded. We know that developing countries face greater volatility, that opening to trade in fact contributes to that volatility, that

developing countries have weak or non-existent safety nets, and that high unemployment is a persistent problem in many if not most developing countries. The developed and less developed countries play on a playing field that is not level. Thus, provisions that look fair on the surface may have very different and unequal consequences for the developed and less developed countries. Accordingly, the power imbalances at the bargaining table are exacerbated by the imbalance of consequences.

There are other dimensions relating to inequality of outcomes that I will discuss later in my talk, but there is one that I want to mention upfront. Standard economic analysis argues that trade liberalization — even unilateral opening of markets — benefits a country. In this view, job loss in one sector will be offset by job creation in another, and the new jobs will be higher-productivity than the old. It is this movement from low- to high-productivity jobs that represents the gain from the national perspective, and explains why, in principle, everyone can be made better off as a result of liberalization. This economic logic requires markets to be working well, however, and in many countries, underdevelopment is an inherent reflection of poorly functioning markets. Thus new jobs are not created, or not created automatically. Moving workers from a low-productivity sector to unemployment does not — let me repeat, does not — increase output. A variety of factors contribute to the failure of jobs to be created, from government regulations, to rigidities in labor markets, to lack of access to capital. But whatever the causes, they have to be addressed simultaneously if we are to make a convincing case for trade liberalization.

Let me underscore this point. There are some sectors of the economy where the standard competitive paradigm does not work well even in developed countries, let alone developing countries. A stark lesson of the recent East Asia crisis is that weak financial institutions can

wreak havoc on an economy, and that strong financial institutions require strong government regulation. But the increased frequency and depth of financial crises in recent years—with close to a hundred countries suffering through such crises over the past quarter-century<sup>4</sup>—has shown how hard it is to establish strong financial institutions, even in developed countries. It has shown also that liberalization—including financial sector liberalization—without the requisite accompanying improvements in regulation and supervision can contribute to financial-sector instability. That instability in turn has exacted great costs in terms of growth, deepening poverty in the crisis countries.

Finally, we need to recognize that while there has been enormous progress made in trade liberalization over the past fifty years under GATT and the WTO, today there exist real threats to that progress. It is not just that future progress may be slow, but there may be, in effect, backsliding, as non-tariff barriers replace tariff barriers, with the former far less transparent than the latter. Perhaps the most egregious of these barriers are anti-dumping and countervailing duties. While there are few topics on which economists agree, one on which there is almost universal consensus is that, as implemented, anti-dumping duties and CVDs make little economic sense; instead, they are very thinly disguised protectionist measures. But the sad fact is that developing countries do learn from the developed countries. They have now learned how to use these protectionist measures, both against each other and against the more developed countries. Indeed, last year, two out of the top four users of anti-dumping measures were developing countries. (Not surprisingly, the US and EU head the list of developed country users.)

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<sup>4</sup> Caprio and Klingebiel (1996) show that 69 countries faced severe banking crises between 1977 and 1995; this count omits all those that have arisen in the past several years. See also World Bank (1999).

This call to fairness, and especially fairness to the developing countries, is one of the two themes that I want to stress in my talk today. There is a second principle which I believe should underlie the coming round of trade negotiations, comprehensiveness. Adherence to the principles of fairness and comprehensiveness could hold open the promise of a more liberal, and more equitable trading regime of the future. While participants in previous Rounds have often paid lip service to these principles, they have been honored mostly in the breach. Future adherence to these principles is, in my mind, absolutely essential for the success of the next round, and in particular if the developing countries are to become full partners in the process of trade liberalization.

#### **Preface: High stakes and political barriers to liberalization**

Before turning in greater detail to these themes, however, there are two topics that I want to discuss briefly: why the stakes for the Development Round are so high, and what the political economy considerations are that provide the context for trade negotiations.

I have said the stakes are high. There are several reasons why this is so, some of which I have already noted. First, the developing countries represent a substantial share of international trade — nearly a third of exports of goods, and nearly a quarter of exports of services.<sup>5</sup> It should be obvious therefore that any meaningful world trading system must take fully into account the interests and concerns of these countries. Second, unless we continue to move forward, there is a real danger of backsliding, as non-tariff barriers replace tariff barriers as impediments to the free movement of goods and services across national boundaries. Third, even to stay still we must

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<sup>5</sup> World Bank (1999).

move forward: the changing composition of national output, and in particular the increasing role of services, mean that we must broaden the scope of international trade agreements. Fourth, for developing countries, there is more at stake than just the efficiency gains from exploitation of comparative advantage; there are also long-term dynamic gains to openness. I believe therefore that trade liberalization is an essential element of the reforms that developing countries must undertake. But if developing countries believe that the playing field of international trade is not level, but is sloped against them, their resulting suspicion and lack of commitment to liberalization will set back not only the trade liberalization agenda, but also the broader reform agenda. Fifth, for the developed countries more is at stake than just a sense of fair play and a humanitarian concern for the poor countries, and for the nearly one and a half billion individuals who live in absolute poverty in those countries. An open and vibrant international trade and investment regime benefits us all. These considerations are important, and should suffice to motivate a real concern for a more balanced round of trade negotiations.

These rationales should give strong impetus to moving forward with a fair and comprehensive Development Round. But what if we resist this impetus? I have argued that trade liberalization is essential for successful development, and that progress in trade liberalization depends on a new round that is truly balanced and inclusive. Then the inverse is clear: if the new round is seen as unbalanced and support for liberalization in the developing world falters, then we are likely to see the emergence of even greater inequalities between the rich and the poor countries, and even more people in poverty. The end of the Cold War and the seeming passing of the threat of Communism should not lull us into a sense of contentment. The implications for global economic and political security of an increasing gap between the haves

and the have-nots should be obvious. Terrorism and political chaos take their toll no less than does the clash of competing superpowers.

Finally, before discussing in greater detail the principles of comprehensiveness and fairness, I want to put the discussion in a political economy context. For two hundred years, economists have articulated forcefully the benefits of trade liberalization, and even of free trade. Indeed, so strong is the case that economists have generally even argued for “unilateral disarmament” — it is in the interests of a country to lower its trade barriers, even if trading partners do not reciprocate.

How then can we explain two persistent tendencies: opposition to free trade is strong and widespread, and even those seemingly favoring liberalization often insist on reciprocity of the kind typically offered by trade negotiations?

The political force behind the resistance to free trade is a simple one: although the country as a whole may be better off under free trade, some special interests will actually be worse off. And though policy could in principle rectify this situation (by using redistribution to make everyone better off), in actuality, the required compensations are seldom paid. Given these circumstances, two groups usually work together in effective opposition to freer trade. The first group consists of firms that benefit from trade restrictions (or that would lose with trade liberalization). Economists have had little tolerance for their cries for sympathy—we typically dismiss them as rent-seekers, special interests that are simply seeking hidden subsidies at the expense of the consumer. The second group consists of workers who are harmed by trade liberalization.

There are four types of workers who may lose out from freer trade: (i) those who work in protected industries and share in rents that will be dissipated by liberalization; (ii) workers in

particular industries who are not receiving rents, but who have industry-specific human capital, the value of which will decrease as a result of trade liberalization; (iii) more generally, workers who will lose their jobs, and are likely to bear moving costs and/or periods of unemployment; (iv) unskilled workers who will see their wages depressed by competition with unskilled workers abroad. While economists have justifiably had little sympathy for the first group, there are more genuine concerns about workers in the other three situations. Advocates of trade liberalization are often reluctant to acknowledge that while the societal gains may exceed the losses, it is not just the case, as many political economists have argued, that the losers are more concentrated than the winners—and therefore more able to advocate their views.<sup>6</sup> There are real losers who are seldom compensated and among these losers are some who are relatively poor.

Let me digress briefly here, since this point raises an interesting question: if affected workers are too weak politically to insist on compensation, how can they be strong enough to block liberalization measures? There are several hypotheses, each of which probably has some validity. First, it is in fact easier to block a change than to initiate one: the status quo has a certain inertia, partly because change involves risks for affected parties.<sup>7</sup> A second reason focuses on coalition formation: import-competing firms may ally themselves with their workers to resist changes, but it is hardly in their interests to assist their workers to receive compensation, which would make the elimination of protection more likely. It is true that export-competing interests might join forces with workers to demand compensation, but there are both standard free-rider problems and important commitment problems: as soon as the trade liberalization

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<sup>6</sup> See, for example, Olson (1965) and Becker (1983).

<sup>7</sup> A measure that, with perfect information, might be a Pareto improvement can actually lower everyone's subjective expected utility, once we take account of the risk that a worker could be significantly worse off after the change.

measure had passed, those exporters would probably prove to be unreliable allies for labor.

What interest would they have in continuing to lobby for compensation?

Thus, in many cases, compensation will not prove politically feasible. Given the lack of compensation, trade liberalization may actually lower social welfare, if due weight is given to the welfare of the poor. This problem will tend to reduce the political viability of liberalization. A second problem is that changing the “rules of the game” introduces considerable uncertainty—so that other workers may ask whether they will be the ones to suffer the next time the rules are changed. Furthermore, if individuals are risk-averse, then fear of future liberalization measures may cause even workers who are not disadvantaged by a particular liberalization to oppose it.

Thus, politicians advocating trade liberalization have tried to make the case for trade liberalization more compelling by introducing the concept of reciprocity: we will lower our trade barriers (threatening our import-competing industries) if others open their markets, which helps our export industries. In many cases, they have focused on the job creation associated with exports, a particularly dangerous argument. For if exports are good because they create jobs, then surely imports must be bad, because they cost jobs. The argument for trade based on jobs—which the Clinton Administration put forward with such force as it pushed for ratification of NAFTA—slides easily then into the economically incoherent position that “trade is good, but imports are bad.” It is the responsibility of good macro-policy—that is, monetary and fiscal policy—rather than of trade policy to maintain the economy at full employment.

This has led to another major fallacy at the heart of many recent political discussions: the idea that unfair trade practices give rise to balance of payments problems. As we all know, the overall trade deficit is a result of savings and investment decisions within a country—that is, of its macro-policy. Of course trade policy can affect exchange rates and bilateral trade deficits.

But the future well-being of a country depends on how much it is borrowing in aggregate: it is the overall trade deficit, not bilateral trade deficits, that matters.

Thus, the argument for trade liberalization is not to eliminate deficits or create jobs, but to allow countries to achieve other aims: first, to exploit their areas of comparative advantage; second, to expand markets, which offers opportunities to take advantage of returns to scale; and finally, to facilitate the flow of knowledge, which increases productivity everywhere. Unless we understand what trade liberalization is about, we risk the danger of a process of trade negotiation that does not focus on the most important issues.

But while we need to recognize the gains from trade liberalization, we cannot ignore the costs. I have already spoken of one set of costs—the losers in the process of trade liberalization who are not compensated. Poor individuals may find it particularly hard to bear these costs. There is another set of costs: complete openness can expose a country to greater risk from external shocks. Poor countries may find it particularly hard to buffer these shocks and to bear the costs they incur, and they typically have weak safety nets, or none at all, to protect the poor. In recent work with Roumeen Islam and Bill Easterly, I have shown that small and more open developing countries suffer more volatility in their growth performance than do other countries.<sup>8</sup> And these concerns are especially serious in countries in which wage dispersions are large and in which unemployment is high.<sup>9</sup>

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<sup>8</sup> See Easterly, Islam, and Stiglitz (1999). Much of the high openness observed in the developing country sample is due to the small size of these economies, rather than to the openness of their trade policies. However, it is clear that other things equal, more open economies will suffer bigger shocks to real income from any given percentage change in their terms of trade than will less open economies.

<sup>9</sup> Even in the United States, there is evidence that those who lose their jobs suffer significant losses in wages; and that those losses are largest for the least educated (poorest) individuals. For recent treatments of this topic, see Wood (1995) and Lawrence (1996).

I do not mean to suggest here that developing countries should avoid liberalization. However, we need to recognize the problems that trade shocks can impose on small, open developing countries, and to help them devise ways, such as the use of commodity risk management tools, to deal with the volatility that goes with the turf.

Even more advanced countries have recognized the need to protect themselves from these costs. As the GATT system has long understood, sometimes the political pressures created by changes in world markets are just too great for politicians to withstand. Even the strongest economies frequently make use of “surge laws”— safeguard provisions designed to provide time for those adversely affected to adjust. Even the United States government, in a period in which unemployment had plummeted to the lowest level in three decades, has worried about the effects of simple trade-opening measures affecting as few as a couple of hundred workers. A classic example is the now-famous broom-corn broom case, in which the protection was invoked through surge laws. The indiscriminate use of anti-surge provisions by developed countries sets a poor example for the developing countries, and clearly undermines criticisms of developing countries that act to protect jobs within their own country. But even worse is the continuing developed-country practice of using anti-dumping laws and countervailing duties in contexts where they are inappropriate. Dumping has a well-defined meaning in economics, but unfortunately, there is a gap between this use of the term and the use in the so-call fair trade legislation, and an even greater gap between that and the way dumping legislation is too often implemented.

More broadly, much of what is done, by developed or developing countries, in responding to market shocks does not make economic sense. Frequently, protective barriers are

put in place to protect one group of workers but end up hurting a much larger and more vulnerable group.

In summary, while I recognize that there are costs associated with liberalization, which animate much of the support for restrictive trade practices, I am convinced that the benefits of trade liberalization far outweigh these costs. These does not grant us license to ignore the costs. Developed countries have recognized the costs, including the political costs, within their own countries, and have introduced provisions in trade agreements to begin to address them. But there has yet to develop a widespread understanding of: (a) the costs of these protective measures; (b) the even greater political and economic costs facing developing countries; or (c) the need to develop a framework that responds effectively to the differentiated needs of developed and developing countries.

### **Trade liberalization: A developing-country perspective**

I have spent some time reviewing the costs and benefits of trade liberalization from a general perspective. Now let me frame the subject from the perspective of a developing country. The perceived costs of liberalizing may well be higher in developing than in more developed countries. But the costs of *not* liberalizing loom even larger: poor countries simply cannot afford either the costs associated with inefficient resource allocation that result from protection or the costs that protection incurs when it reduces outside flows of investment and ideas that protectionism tends to engender.

Let me elaborate on this point briefly. I have argued elsewhere that true development entails a transformation of society.<sup>10</sup> For poorer countries especially, excessive protection shields local residents from a key transformative mechanism. Trade and investment can bring knowledge. Openness to trade does not just make it possible for consumers to consume at lower cost, as suggested by standard models of trade; it also opens up new possibilities by forcing firms to innovate and by offering them new inputs and intermediate goods that embody new knowledge. Foreign direct investment can bring with it not just investment capital, but also scarce human capital, new ways of organizing production, and access to international marketing channels and knowledge networks.

In this view then, the costs of protectionism are potentially very high for poorer countries. Yet it is also true that in democratic developing countries, governments have to persuade their citizens of the virtues of liberalization, and there are always demagogues ready to exploit worries about liberalization—just as there are in more advanced countries. As I have noted, when unemployment rates are high and job opportunities are limited, as is so often the case in developing countries, worries about job losses will be far greater. And more developed countries — through both their rhetoric and their actions — have too often failed to be helpful to those genuinely committed to the cause of liberalization in developing countries. Let me suggest several ways in which this is the case.

First, we need to provide some context for current efforts to increase market access in developing countries. Today those appeals are based on sound economic arguments, but it was not so long ago that gunboat diplomacy—or worse, as in the case of the Opium Wars—was used to persuade recalcitrant countries to open their markets. No pretense at reciprocity was made: it

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<sup>10</sup> Stiglitz (1998).

was a bald-faced show of power. The trade treaties imposed from outside were far from even-handed.

I raise this not to reopen sore wounds of the colonial era, but to point out that these experiences are very much part of the consciousness in developing countries. What has caused these historical wounds to fester is the seeming hypocrisy exercised by those in the developed countries: although they preach the virtues of openness, too often we see that in areas where they lack comparative advantage—areas like agriculture, textiles and steel—the developed countries engage in strong protectionist measures.

Nowhere is this hypocrisy greater than in the invocation of dumping and countervailing duties. I remember clearly the conversations I had in 1993 with the first deputy prime minister of Russia, as the United States was threatening to invoke dumping duties on Russia's exports of aluminum. He knew, and I knew, and he *knew* that I knew that Russia was not dumping—at least in the sense that any economist would use that term. We both knew that the dumping laws are not based on principles of fair competition; if that was their intention, there would be no problem with harmonizing those laws with competition laws. The alleged objective of dumping laws is to prevent predatory pricing, which is already an offence under competition laws. But the criteria for predation under competition laws, which are based on sound economic principles, are far more stringent than those specified under anti-dumping laws. Indeed, according to one calculation made a few years ago, if the standards used under the dumping laws were applied domestically, 18 of the 20 top Fortune 500 firms in the United States could be accused of dumping!<sup>11</sup> And the resolution of the “problem”—what amounted to the establishment of an international aluminum cartel *under the auspices of the governments of the advanced market*

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<sup>11</sup> Thurow (1985).

*economies*—did little to convince skeptics of the market that anyone truly believed in the competitive marketplace.

Thus, to many in the developing world, trade policy in the more advanced countries seems to be more a matter of self-interest than of general principle. When good economic analysis works in favor of self-interest, it is invoked; but when it does not, so much the worse for economic principles. “Yes,” the advanced countries seem to be telling the economies in transition (and the emerging economies), “produce what you can—but if you gain a competitive advantage over our firms, beware!” Too often, there is a not-so-subtle subtext: “Clearly, if there were a level playing field, we could outperform you. Since you seem to be underselling us, it could only be because you are engaging in unfair trade practices!”

Several recent events have reinforced this impression. Consider the crisis in East Asia. The conditions imposed through the rescue packages included trade liberalization measures that were unrelated to the crisis.<sup>12</sup> To many, it seemed simply that those who wanted to force market-opening measures had seized on an opportune time to make use of their temporary power. Subsequent events strengthened the view that market-opening measures were not always advocated with the crisis countries’ best interests at heart. As the crisis economies weakened further and excess capacity proliferated, natural market adjustments led to a decline in the prices of a number of commodities, including oil and steel. In capital-intensive industries where short-run marginal costs lies far below long run marginal costs, this drop in prices can be quite large.

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<sup>12</sup> Feldstein (1998).

This is part of the market-equilibrating forces; it is not dumping, and should not be interpreted as such. Yet, the dumping laws have been invoked in the case of steel.<sup>13</sup>

The establishment of the World Trade Organization, and the associated improvement in the international dispute resolution mechanisms, was one of the major advances of the Uruguay Round. Yet when major countries either fail to deal with trade disputes through that mechanism or fail to comply with the rulings that are issued,<sup>14</sup> it undermines confidence in the international dispute resolution mechanism.

I should be clear: I do not mean to be excessively critical. Sometimes, as I look back at the years I spent at the White House, I think of how much time was spent managing these trade issues—from Chinese honey, to Mexican tomatoes and avocados, to agricultural export subsidies (provided under the innocuous-sounding name “Export Enhancement Program,” or EEP). But although these cases occupied much of our time and represented the most egregious cases of special-interest politics, they also represented but a small fraction of GDP. That we were able to turn back some protectionist appeals, that we discouraged others from even attempting to get special favors, that apart from aluminum, there was no major expansion of protectionism in a span of four years, gave me some comfort. Yet, I also knew that I should not take too much comfort from this: after all, throughout this period, the United States was enjoying a major economic expansion and unemployment was declining steadily. I worried that protectionist sentiment would soar, and the effectiveness of protectionist measures like anti-dumping appeals

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<sup>13</sup> Matters are even more complicated than this brief discussion suggests: according to some accounts, the surge in imports of steel has as much to do with the lagged effects of anticipations of capacity constraints in the United States as it does with falling prices abroad.

<sup>14</sup> What matters here is as much the perception as the legalisms; a good illustration is provided by the famous banana dispute involving the US, Central America, and the European Union. It is also true, to be sure, that in at least some of cases disputes involved unfair trade practices that were not dealt with under existing WTO provisions.

would increase, during the next recession—just as it had during the last major recession in the early 1980s. At that time, by one account, non-tariff measures covered two-fifths of all U.S. imports.<sup>15</sup>

Let me sum up my discussion of political factors in liberalization. Although there are real gains to be had — both for developed and developing countries — from trade liberalization, there are also losers. The political process is one in which special interests often triumph over general interests. In a democratic society, the majority must be convinced that they will benefit from — or least, do not face significant risks of being hurt by — liberalization. The special interests, regrettably, often masquerade under the guise of general interests, using concerns for the poor to motivate sustaining their ill-gotten gains. All too often, more advanced countries, both through their actions and their rhetoric, worsen the plight of the honest politician in a developing country who is trying to persuade his electorate to support liberalization.

### **The basic principles**

I am now ready to set forth what I see as the two basic principles that should govern the next set of trade negotiations: *fairness*, and especially fairness to the developing countries, and *comprehensiveness*. By “comprehensiveness,” I refer to the need to include in the Round not only issues that are of central importance to the developed countries, such as financial market liberalization and information technology, but also those, such as construction and maritime services, that are important to developing countries. At first blush, one might ask, how can one

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<sup>15</sup> See Nogués, Olechowski, and Winters (1986). The extent of protection may be even greater, since the threat of invoking dumping duties may have a protectionist effect, even when they are not actually levied.

object to either principle? Yet closer examination raises doubts about the extent to which previous Rounds have embodied these principles.

For instance, the Uruguay Round and previous rounds focused heavily on liberalizing tariffs on manufacturing. They did little to reduce protection in agriculture, a sector in which many developing countries have a comparative advantage<sup>16</sup>. The agricultural liberalization that occurred was driven largely by the interests of developed exporters such as the United States and Australia, and developing country exporters in the Cairns group. Exporters of tropical products did not play an active role in the design of the agricultural liberalization agenda.

In agricultural goods, tariffication of quotas during the Uruguay Round has left tariffs very high. Recent calculations show that in advanced industrial economies, the production-weighted average nominal rate of trade assistance to agriculture was 33 percent — compared with a mere 2 percent for other primary and manufacturing industries!<sup>17</sup> Protection to OECD agriculture actually rose, from 32 percent in 1997 to 37 percent in 1998 (OECD 1999). It would be understandable if agricultural exporters wondered whether previous Rounds had their best interests at heart.

Moving ahead on the agricultural issue in this Round would have big payoffs. Abolition of agricultural export subsidies and achievement of sharp cuts in import tariffs would benefit most developing countries. Research presented at this conference suggests that a 40 percent reduction in agricultural support policies globally would contribute almost exactly the same amount to global welfare as a 40 percent cut in manufacturing tariffs.<sup>18</sup> This reflects the huge

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<sup>16</sup> While agricultural liberalization was undermined by “dirty tariffication”, there was progress in some important cases, such as the reduction in protection in the Japanese markets for wheat, coarse grains and sugar. See Ingco (1996, pp. 444-45).

<sup>17</sup> Anderson, Hoekman, and Strutt (1999).

<sup>18</sup> Hertel and Martin (1999).

size of distortions in agriculture relative to manufacturing, despite the fact that manufacturing value added is two-and-a-half times that of agriculture globally.

***Comprehensiveness, fairness and political success:*** The reason that there must be at least a perception of fairness and a reality of comprehensiveness relate to what I have already said: If trade liberalization is to survive the political process, it must have clear advocates—those who see themselves as gaining from the multilateral Rounds. Only if there are significant gainers in the developing countries as well as the developed countries will such initiatives muster sufficient support. Indeed, one can see this dynamic play out even in countries seemingly committed to market processes, like the United States. In the intense political battle to get NAFTA and the Uruguay Round ratified, the export industries that benefited from increased market access played a pivotal role. If, by contrast, the trade negotiations are viewed as unfair, then it is not just populist demagogues who will seize upon this unfairness as an excuse for resisting liberalization, possibly setting back attempts to implement broader-based market reforms as well.

As should by now be clear, the concepts of comprehensiveness and fairness are closely related: Only if the negotiations are sufficiently comprehensive to include the interests of developing countries, and their exporters, is there likely to be success. In the discussion below, however, I will argue that there are several other important dimensions of comprehensiveness, which go beyond sectoral comprehensiveness. But before turning to these, let me say a few more words about sectoral comprehensiveness.

*Sectoral comprehensiveness:* Comprehensive negotiations, as opposed to negotiations focusing on a limited number of sectors, provides much more scope for designing policies that will compensate at least countries, and potentially even groups within countries, by including additional items that provide compensation to those who would otherwise lose. Consider, for example, France in the Uruguay Round. While many French policy makers thought of themselves as losing from the restraints on farm subsidies included in the Round, they recognized the potential gains to their exporters of services from liberalizing trade in services. For the new negotiations to be a success from a developing country perspective it is vital that developing countries be able to identify their objectives in areas such as services, and to pursue them actively.

Recent World Bank research highlights a surprising advantage of a comprehensive approach to future negotiations. Since the built-in agenda for the negotiations includes agriculture and services, one of the primary questions will be whether to include industrial products—an issue that would typically be assumed to be of primary interest to developed countries. However, this should no longer be the case. Bank research presented at this conference<sup>19</sup> shows that manufactures exports now make up over seventy percent of the exports of developing countries, and seem poised to rise close to eighty percent by 2005. This raises the clear possibility that the developing countries will actually be the predominant beneficiaries of the inclusion of manufacturing in the negotiations — though of course, whether they are depends on the particular manufactured commodities that are included.

Many observers view with great concern the alternative to a new round of trade negotiations—the sector-by-sector approach. It is not only that progress is likely to be slower

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<sup>19</sup> See Hertel and Martin (1999).

under this approach, but also that any successful sectoral liberalization may actually impede further success in the next multilateral round. Those who succeed in getting the trade liberalization measures that they need (like IT) cease being as potent a force for trade liberalization as they might otherwise be. With less “money” on the table for potential exporters, making a deal in other sectors becomes all the more difficult. After they have already cherry-picked their favored sectors, what can the United States or European governments hope to gain in compensation for the political costs of liberalizing the agricultural sector?

*Special interests and the liberalization agenda:* There is a certain irony in the way that trade negotiations have typically proceeded. One might have thought that each country would promote liberalization in those sectors where it had the most to gain from a societal perspective; and similarly, that it would be most willing to give up protectionism in those sectors where protection was costing the most. But political logic prevails over economic logic: after all, if economic logic dominated, countries would engage in trade liberalization on their own. High levels of protection in a sector are usually indicative of strong political forces, and so these higher barriers may be the last to give way. By the same token, market access initiatives are not determined primarily by considerations of the national interest, but by special interests. When I was at the Council of Economic Advisers, there was an attempt to do it the right way, to ask questions like “What trade-opening measures would have the largest effect on U.S. income, and which should be given the highest priority, taking also into account our concern with distribution?” But such a strategy based on economic logic would have pushed off the trade agenda many items that were of great interest to special interest groups, but of little value (and, in some cases, from a broader perspective, arguably of negative value) to the country as a whole.

In this context, it should not come as a surprise that this attempt to have economic logic drive the trade agenda was quickly suppressed.

This observation has an important implication. To the extent that major industrial countries have shaped multilateral trade negotiations in the past, then the agenda has presumably reflected not so much their *national* interests, but the interests of certain domestic political forces. Comprehensive multilateral negotiations offer a possibility of taming those forces: the multiplicity of gains across sectors increases the number of potential winners, so that the process can yield an outcome that is closer to a Pareto improvement — economists' jargon for a situation where everyone is better off after the negotiations.

***Going beyond liberalization of goods to liberalization of services:*** While there has been a reluctance on the part of some countries to go beyond manufactured goods into agriculture—as they see their protected industries potentially threatened—there is a natural desire to expand negotiations to include services, which represent an increasing share of GDP in virtually all economies. In the United States, for instance, the share of manufacturing has declined from 28 percent in 1960 to 18 percent today; in the UK, from 36 percent to 21 percent. In both countries, the share of services has risen by an even greater amount. Even developing countries should have an increasing interest in including services, as their economies shift into those sectors: Brazil and India, for example, have both seen their services shares increase by more than 10 percentage points since the early 1960s.<sup>20</sup>

But services are different from manufactured goods in several salient ways—ways that make achieving fairness, especially fairness in outcome, far more difficult, and far more difficult

than is generally realized. I want to illustrate this by two examples, one focusing on liberalization of financial services, the other on liberalization of construction services.

. Modern financial markets are clearly important for economic efficiency, and global financial institutions play an important role in promoting global economic integration, including trade expansion. But financial markets are different from ordinary markets, where our standard theorems about the gains from trade liberalization in the presence of competitive markets apply. The central functions of financial markets are related to the provision of information, and markets for information function differently from markets for ordinary goods and services. This fundamental difference explains why all countries accept a need for financial regulation that all agree would be totally inappropriate for the typical manufacturing sector. Indeed, the global financial crisis of the last eighteen months should have sensitized us to the downside risks of rapid liberalization of financial markets in countries that lack the appropriate regulatory structure. If domestic banks in the liberalizing country are weak, then providing an easy avenue for depositors to switch funds to a safer foreign-owned bank could spark a run on the domestic banking system. Even short of that, the additional competition may erode the franchise value of the bank, and that itself may lead to more risk-taking, or more broadly less prudential behavior, on the part of domestic banks. Thus, even countries with reasonably good systems of bank regulation will need to tighten up and improve their financial sector regulations even as they liberalize the market more broadly.

In actuality, countries liberalizing their financial systems have failed to take these precautions. Typically, these countries have not only have failed to recognize the need to do so, but instead have moved in the opposite direction, loosening their regulatory frameworks in the

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<sup>20</sup> These data are taken from the World Bank Statistical Information and Management Analysis

euphoria of liberalization. In retrospect, it should be clear to all that in many countries the objective should not have been deregulation, but the establishment of an appropriate regulatory framework. But even with the appropriate objectives, policymakers and regulators would have found the going tough. In country after country, the new foreign entrants into the financial system have recruited away the best and most talented individuals from the government regulating agencies. Unable to compete on salaries, regulatory agencies have found themselves much weaker just at the time that they need to be strengthened.

Nor should we ignore the longer-run development problems that can arise when foreign banks displace domestic banks: these foreign banks may focus their lending efforts on providing finance to multinationals or large national firms, but may show little interest in small and medium enterprises, which are often the engines of growth. These fears seem to have been realized in practice.

To be sure, if countries manage to strengthen their financial sector regulation as they liberalize, and if they manage to ensure that funds reach small and medium-sized enterprises and other underserved groups,<sup>21</sup> then financial sector liberalization has the potential for improving the performance of this vital sector of the economy. The induced competition can be an important spur to efficiency of the sector. But there are clearly examples (Kenya, for example) where foreign entry, even in the presence of financial-sector liberalization, has failed not only in that objective, but also in the broader objective of reducing interest-rate spreads and bringing

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database.

<sup>21</sup> Perhaps by following and broadening the U.S. example of lending obligations to such groups, as under the Community Reinvestment Act.

down the rates at which funds are available to borrowers. Thus, the liberalization of financial services in developing countries should be approached with some caution.<sup>22</sup>

*Comprehensiveness of factors and liberalization of services:* Let me mention one other type of comprehensiveness that is important to developing countries: comprehensiveness across factors of production. Many developing countries today are raising a key question, perhaps somewhat rhetorically, about the scope of liberalization: Why is it that there has been so much interest in liberalizing movements in goods and in capital—issues of concern to industrial countries—but so little interest in liberalizing movements of people, especially unskilled labor, the factor that is of particular interest to developing countries? The issue becomes of central importance once one starts to focus on services. If industrial-country companies are to deliver effectively services like insurance, they must be allowed to have at least some of their key personnel working in the country. Allowing some individuals to enter is thus a corollary to liberalization of services. But developing countries have an interest in industries like construction; success in these areas may require larger numbers of somewhat less skilled workers. In both cases, the discussion is about temporary work permits, not long-term migration.

What is at stake is partly a matter of equity, but there are also issues of efficiency: services and goods, flows of investment and people, are all interlinked. Barriers in one area limit possibilities in others. That is why it would be desirable to make progress towards an investment agreement—though the agreement needs to be attentive to the concerns of the developing countries as well as the developed.

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<sup>22</sup> The same is true, as I have argued elsewhere (see, for example, Furman and Stiglitz 1998), in the case of liberalization of capital flows. I would hate to see openness equated with full

*Beyond tariffs:* There is a second sense of comprehensiveness—beyond including all sectors—that I want to emphasize: comprehensiveness of instruments. Today, we recognize that there are many forms of non-tariff barriers to trade (NTBs), and that these have multiplied in recent decades as tariff barriers have come down. This is not surprising; after all, the political forces that give rise to high tariffs do not disappear once tariffs are brought down. Rather, they must seek protection through other channels.<sup>23</sup> Unfortunately, these NTBs are far more pernicious than tariffs, precisely because they are so much harder to assess and quantify, and they can exact even higher costs in efficiency terms. And while previous Rounds have addressed some of these issues—through tariffication of agricultural trade barriers, for example—the problem has not gone away.

One notorious form of GATT/WTO-legal NTBs is anti-dumping duties and countervailing duties. I have already noted that the provisions of dumping laws do not conform to economic principles concerning fair trade. One of the unfortunate lessons that the developing countries have learned from their more developed trading partners is how to use dumping laws to protect themselves. In fact, they've proven to be quick learners. Even as the number of anti-dumping actions initiated in developed economies fell sharply after 1993, the number of actions in developing countries tripled. Even worse, developing countries have trained the weapon of AD against each other: in 1996-97, for example, Argentina, Brazil, India, Indonesia, Korea, and Peru all initiated anti-dumping actions against China.<sup>24</sup> Although the US has led the way in this

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liberalization of capital flows, given that premature liberalization can have severely anti-developmental effects.

<sup>23</sup> Finger (1998) refers to this phenomenon as the “fungibility” of protection across different trade-policy instruments.

<sup>24</sup> Finger (1998).

form of protection—so that even in 1996-97, it initiated twice as many AD cases as any other jurisdiction—in the long run, competitive and innovative countries like the United States have the most to lose from anti-dumping. Their low profit margins make them particularly vulnerable to charges of selling below “reasonable costs,” which are assumed to include an arbitrary and sometimes very large profit margin;<sup>25</sup> and falling prices from innovation make it more plausible that charges of injury will be sustained.

The use of countervailing duties has raised similar concerns about non-tariff protectionism. Most economists would agree that if privatization is carried out via a competitive auction of assets, then the purchaser has not been subsidized. That is, he has paid full market price for the assets that he has purchased, even if the seller, the government, has lost money in the deal. Imagine that one claimed, conversely, that there was a subsidy involved simply because the government had made a mistake in the past and was now being forced to sell the asset below cost. To be consistent, one would have to hold also that a company that purchased assets from a bankrupt firm was being subsidized by the bankrupt firm, if the price it paid for assets was less than the price originally paid by the bankrupt firm. This logic, untenable though it may be, has been used to justify countervailing duties imposed against exports from the transition economies.<sup>26</sup>

But problems arise not only in the anti-dumping and CVD laws, but also in their implementation process, which puts developing countries at a disadvantage. The information requirements imposed on firms charged with dumping are particularly onerous for developing countries, and the default, the reliance on “best information available”—typically meaning the information supplied by the party alleging dumping—puts developing countries at a further

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<sup>25</sup> Some recent cases have assumed a profit margin as high as 30 percent.

disadvantage. A comprehensive trade negotiation thus must deal not only with the principles underlying the laws, but also with details of their implementation.

There is a simple principle that should underlie our thinking in this area. “Fair trade”—or as economists put it, fair competition—is important, but the principles that should guide us in assessing whether a firm is engaged in an unfair practice should be the same whether the practice occurs within a country or across borders. Recent cases have made it abundantly clear that price-fixing can occur, for instance, at the international level, just as it can occur within the borders of a country. Anti-dumping is, or should be, concerned with predatory pricing, which is a practice that can undermine the effectiveness of competition. Anti-trust laws have developed relatively clear and implementable standards for whether a given pricing structure is predatory. These are the standards that should be used for transactions that move across borders—that is, for trade. What would happen if these standards were applied? According to one recent analysis of US anti-dumping cases, in more than 90 percent no intervention was needed to prevent predation, or to protect competition at all.<sup>27</sup>

***Promoting competition:*** Ironically, while the unfair fair trade laws have encouraged protectionism under the guise of protecting competition, there has been insufficient progress in attacking competition barriers in areas where they really are important. For instance, some countries have monopoly importers. Reducing tariffs simply gives those importers scope for increasing their profits, rather than facilitating trade; so it should be clear that competition is necessary to realize the full gains from trade. Effective competition policy may also improve the workings of political processes. When competition is muffled, firms and government officials

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<sup>26</sup> And developed economies as well: a case in point was British Steel post-privatization.

will tend to divide up economic rents — that is, the monopoly profits — in secret. But with vibrant competition, companies have an incentive to make sure rules are clearly defined and that their rivals get no unfair advantages. Competition allows the emergence of multiple important actors, promoting pluralism and ultimately also efficiency.

In the international arena, lack of competition may be an important barrier to trade. It may be especially important to new entrants—and many economies in transition and developing countries are new entrants into a market. Thus, they have a strong interest in seeing these barriers broken down. Earlier, I referred to how the existing aluminum producers in the West worked together, under the umbrella of the anti-dumping duty, to limit Russia's entry into this market.

These considerations suggest that negotiating countries should consider initiating multilateral negotiations on competition policy. I know that developing countries are far from unanimous on support of such a competition accord. This ambivalence is perfectly consistent with my earlier discussion about the political economy of trade liberalization. Competition policy has few supporters within any country, other than economists who realize the central role it plays in making markets work perfectly. (Businesses typically believe in the virtues of competition in *other* sectors, arguing that in their own sectors, competition tends to be disruptive). Given the lack of interest on the part of the vested interests, I am not sanguine about whether there will be any progress in this direction.<sup>28</sup> Yet those of us who believe that trade liberalization can be an effective tool for development and welfare improvement — but especially if, and in some cases only if, it is accompanied by competition — cannot let this item slip off the agenda without raising our voices.

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<sup>27</sup> See Willig (1998).

Some observers have also raised concerns that if competition policy is treated through the WTO, it will be the market-access concerns of developed-country exporters and not those of developing-country consumers that drive competition policy in developing countries.<sup>29</sup> In this view, developing countries would be better off improving their competition policy frameworks unilaterally. Although these are important concerns, promotion of competition policy brings such important benefits that I believe it warrants serious consideration as part of the next Round. A further advantage, of course, is that a competition accord could reduce tolerance for the use of anti-dumping actions as a remedy for alleged predation.

*New trade barriers:* Developed countries have shown enormous creativity in *creating* barriers to trade—well beyond the antidumping laws and the ways that they are implemented. The most difficult to deal with are those that align protectionist interests with the interests of other pressure groups. Agricultural interests, for example, foment *Jurassic Park* worries about genetic engineering to keep out genetically engineered plants and animals. Of course, where agricultural subsidies are sufficiently high, any technological advance is, perversely, of doubtful value because it increases the demand for agricultural subsidies. Little wonder that opposition to genetic engineering is stronger in those countries with high agricultural protection than in agricultural exporters. The current broad-based opposition to genetically engineered products may provide another means for developed countries to restrict access for unsubsidized exports from developing countries. This is an issue, of course, that currently may be of second-order interest to developing countries. Their immediate concern is simply to gain access to markets and to level the playing field by getting the advanced industrial countries to stop subsidizing

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<sup>28</sup> Croome (1998).

agriculture. But in the longer run, this issue cannot be ignored. For increases in productivity in the developing countries will depend in part on the improvement in their seeds, and genetic engineering holds open the promise of the most rapid improvement in that productivity. (Interestingly, the charges of anti-competitive practices recently brought against the industry underline the key role of competition policy, if the benefits of these advances are to be shared meaningfully with those in the developing world.)

Other protectionists try to enlist environmental and labor groups for other types of protection. While it is imperative that the international community continue to pursue good environmental policies and core labor standards, it should resist this unholy alliance of interests. Take the example of the environment. Once international agreements are concluded on global environmental issues, like HFCs and greenhouse gases, and if it becomes clear that other enforcement measures have failed, then it may become appropriate to ask whether trade sanctions should be used. But interestingly, there have not been major enforcement problems with the one major international agreement that included binding commitments, the Montreal Convention. If there is a decision eventually to proceed with the use of trade sanctions, it is important that the imposition of the sanctions be delegated to an international body. It should not be left up to individual countries to decide for themselves whether they like or do not like the environmental policy of a trading partner. That would simply be an invitation to new forms of protectionism.

***Trade facilitation:*** I have focused so far on the need to strengthen international restraints on the use of these various forms of NTBs. But my hope is that the trade negotiations will go

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<sup>29</sup> Hoekman and Holmes (1999).

beyond stripping down these government-created barriers to trade and will work more actively to facilitate trade. We should ask what the barriers to trade are, and how they can be removed. I have already provided one illustration of such barriers: anti-competitive practices. Promoting competition is one area for facilitating trade, if we interpret that concept broadly. But there are also important steps to take in the area of trade facilitation more narrowly. In many developing countries, corruption by customs officials acts as another important barrier to trade. Considerable thought should go into the question of how the international regime can help address this problem—from pre-clearing, to technical assistance, to simplification of classification schemes that leaves less discretion to customs officials.

*Other dimensions of fairness:* I have focused so far mainly on the issue of comprehensiveness, arguing that comprehensiveness is in fact necessary for an equitable agreement. But there are other elements of perceived fairness. Over the years, many developing countries have unilaterally (though often under strong pressure) engaged in a wide variety of trade liberalization measures. I agree with those who have argued that as we approach the new round, those countries need to be given credit for their concessions, in return for making them binding.

Another aspect of fairness entails *sensitivity* to the special needs of developing countries. There are at least three dimensions to this sensitivity. First, developed countries should recognize the higher costs of liberalization in developing countries, which I discussed earlier. Allowing longer transition times for liberalization measures, as was done during the Uruguay Round, lowers the cost of adjustment; but in addition to this concession, the more developed countries should consider establishing a formal program of trade adjustment assistance. And we

should be clear—the costs of implementation can be very high. Finger and Schuler, in their paper presented to this conference, argue that implementation of just a few of the Uruguay Round agreements can swallow up a year’s worth of development assistance for a country.<sup>30</sup> The World Bank has played an important role in the provision of such support for implementation, and will continue to do so in the future. Nevertheless, more assistance is clearly needed.

The second point has to do with the special problems posed by human needs, like health. It has been alleged that some developed-country drug companies, for instance, sell their drugs to developing countries at prices that exceed their prices in developed-country markets. That they might be able to do so is not surprising: intellectual property rights give drug firms scope for price discrimination; in particular, the larger developed countries with national health systems can win more favorable pricing from pharmaceutical firms.<sup>31</sup> Yet as reasonable and rational as price discrimination might seem for profit-maximizing enterprises, to those in less developed countries it appears exploitative. Within the United States and other countries, such exercises of monopoly power—that is, price discrimination not justified by differences in costs of serving different customers—is illegal. It might be appropriate to consider a similar provision in the next round of trade negotiations.<sup>32</sup> We need to explore various ways to achieve the goal of ensuring that developing countries achieve “most favored pricing” status.

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<sup>30</sup> Finger and Schuler (1999). These estimates cover only the budgetary outlays required of the government — for example, for new computer systems and training of personnel — and thus do not encompass any adjustment costs to private-sector firms or workers.

<sup>31</sup> The issue is a complicated one, since standard models of the discriminating monopolist do not adequately describe those markets in which there is a single buyer of prescription drugs (the national health service), for then the appropriate model is that of bilateral monopoly.

<sup>32</sup> In fact, there have been moves by drug manufacturers to try to write restrictions on parallel imports into the WTO, *increasing* the scope for price discrimination. In my view, this would be a risky move in the absence of good recent evidence that shows that price discrimination

Third, the negotiations need to pay special attention to the long-term growth aspirations of the less developed countries. This has several dimensions. I have already referred to one—how poorly designed financial services liberalization can lead to greater instability and perhaps even starve small and medium enterprises of needed capital. Similarly, definitions of intellectual property rights need to take into account the interests of users of knowledge as well as producers of knowledge. If they do not, then enforcement of those rights may constrain development. (Interestingly, some members of the academic community, which is both a producer and user of knowledge, share the developing-country concern that the international community has yet to strike the right balance between users and producers.)

More problematic in this vein are issues related to *promotion of infant industries*, which has justified so much protectionism in the past. Certain types of technology subsidies were given the “green light” under the Uruguay Round, but it is clear that developed countries make use of a whole variety of other, hidden subsidies under the rubric of “defense”. This point was illustrated by the recent debates about dual-use technologies and subsidies to aircraft manufacturers. The technology issues facing developing countries are different, but no less important. These countries must absorb new technologies; and to do so, they must have the space to engage in a process of learning-by-doing, during which costs fall. With imperfect capital markets, firms cannot simply borrow against future profits, and governments may need to step in. We must find some way of accommodating these very real concerns of developing countries.<sup>33</sup>

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benefits, rather than harms, developing country consumers. (The World Bank is carrying out a study to address this issue.)

<sup>33</sup> Article XVIII, Section A, of the GATT does provide an explicit mechanism for infant industry protection, but that provision has been little used, presumably because of the requirement for compensation of trading partners, as well as the backlash in recent years against abuse of infant-industry arguments. But going forward, it will be important to ensure that the legitimate development concerns of poorer countries are reflected in the international trade rules — even

***Trade and the development agenda:*** Trade liberalization, while necessary, is not sufficient for developing countries to reap the full benefits from integration with the world economy. Much of the trade agenda now goes beyond the border, into areas such as domestic regulation, intellectual property rights, the efficiency of customs administration, and conformity with standards. Further, the ability of a country, and particularly of the more isolated communities within a country, to participate in trade depends upon the quality of the transport and communications infrastructure that allows them to access the world trading system.

The new, broader agenda for international trade involves many issues that are much more difficult to implement than trade liberalization, which, after all, can be implemented at the stroke of a pen once the necessary agreement has been obtained. Efficient infrastructure requires years of investment both in the regulatory framework under which it is supplied, and in the infrastructure itself. Similarly, improving the efficiency of customs is likely to require strengthening of the Customs Administration in many countries. Establishing a strong financial regulatory structure — so that opening up markets for financial services strengthens economic performance rather than contributing to economic instability — is no easy task, even for more advanced countries.

The broader agenda opens up the prospect that trade liberalization may yield even more benefits than it has in the past. But I should be quick to add: from the perspective of the developing country, what is crucial for growth is access to markets abroad, especially in the developed countries. The East Asia miracle was based on export-oriented policies that took

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while guarding against the development-impeding types of protectionism that have so often been justified using infant-industry arguments. Part of the task will be to preserve and raise awareness of provisions *already* available within the trade rules that may serve some development needs. One example is the Article XIX safeguard provisions, which permit transparent protection of limited duration without requiring compensation.

advantage of increasing access. Such policies play a critical role in raising quality within the developing countries, in promoting the transfer of technology, and in enforcing the discipline of competition. In my Prebisch Lecture, delivered here in Geneva to UNCTAD almost a year ago, I described the development process as a transformation of society, and I argued that openness to the outside in general, and trade in particular, can play a central role in that transformation.<sup>34</sup> As I said then, “retreat from openness in the developing world would unacceptably delay the development transformation that it so sorely needs.” In short, for developing countries more is at stake than simply the exploitation of the gains from comparative advantages, as important as those gains are for static economic efficiency. Trade is vital to the dynamics of successful development.

The convergence of the trade and development agendas requires greater cooperation between the agencies involved in development policy, and those focused on trade. Such cooperation is one of the key features of the Integrated Framework for the Least Developed Countries. Clearly, however, the same needs exist in a much broader group of developing countries, and we and our WTO colleagues will need to work closely if we are to achieve our shared objectives in this new era.

## **Concluding remarks**

The two principles that I have offered here, fairness and comprehensiveness, are strongly linked. A comprehensive approach to trade will not only be more effective in attaining the

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<sup>34</sup> Stiglitz (1998).

objectives of trade liberalization, but it will also be perceived as fairer. This perception will, I have argued, not only enhance the chances of trade liberalization within developing countries, but also increase their enthusiasm for a broader range of market reforms. A comprehensive Round that adequately represents the interests of developing countries will deflate the sentiment that market economics is a theory invoked only in the pursuit of developed-country interests, and it will increase awareness that vigorous market competition brings benefits to any economy.

Both the political and economic stakes are high. If we fail—if the developed countries allow their special interests to prevail over their national interests, both in terms of their offers of market access and their demands on the developing world for market access—then our failure will undermine confidence in democratic processes everywhere. Clearly, the developed countries have much to gain from a more integrated global economy, and they have much to gain from reducing their distortionary policies. But they can afford the luxury of the inefficiencies of the existing distortions, and they have demonstrated an impressive capacity to dismiss or overlook the intellectual inconsistencies—to use a mild term—in some of their positions.

The developing countries cannot afford such economic distortions; the evidence of the last three decades strongly supports the conclusion that market-oriented policies, including outward-oriented policies, provide their best hope for sustained growth. Such growth is absolutely necessary if poverty within these countries is to be eradicated.

The Millennium Round provides a great opportunity. It can reinforce the movement toward true market economies, enhancing competition and promoting economic and societal transformation. At the same time, by reducing trade barriers, and thereby eliminating some of the major sources of corruption and lack of transparency, the Round can strengthen democratic processes.

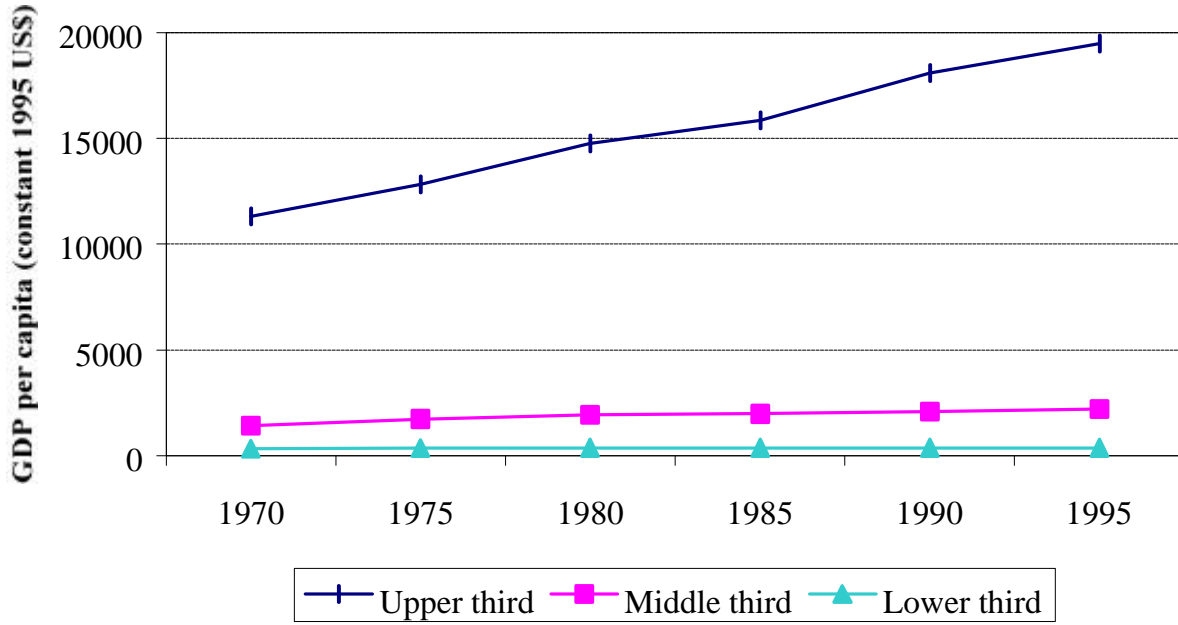
But the Round also poses great risks. If negotiations follow historical patterns — hard bargaining motivated by special interests within developed countries, with too little attention paid to the interests of the developing countries — the Millennium Round could strengthen the hand of those in the developing world who resist market reforms and an outward orientation. It could give confirmation and ammunition to those who see relations between the Third World and the developed countries through the prism of conflict and exploitation, rather than recognizing the potential for cooperation and mutual gain. Outward-oriented policies will succeed only to the extent that there are markets in which developing countries can sell their products, as well as international rules that allow developing countries to make good use of their areas of comparative advantage.

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Graph 1  
Incomes of Rich and Poor Nations Continue to Diverge



Source: World Bank, World Development Indicators 1999.