

## HOW TO MAKE THE TRADE REGIME WORK FOR DEVELOPMENT

Dani Rodrik  
Harvard University  
February 2004

The purpose of the World Trade Organization (WTO) is, or should be, to raise living standards around the world through the establishment of a fair set of rules for world trade. This point is widely recognized, not least in the agreement establishing the World Trade Organisation (WTO). Increasingly, however, the WTO and multilateral lending agencies have come to view the goals of promoting development and maximising trade as synonymous, to the point where the latter now easily substitutes for the former. The net result is a confounding of ends and means. Trade has become the lens through which development is perceived, rather than the other way around.

Imagine a trading regime in which trade rules are determined so as to maximise development potential, particularly of the poorest nations in the world. Instead of asking, "how do we maximise trade and market access?" negotiators would ask, "how do we enable countries to grow out of poverty?" Would such a regime look different than the one that exists currently? And how would such a regime compare to the agenda of the so-called Doha "Development" Round?

### Where the gains are not

One of the mysteries of the current round of trade negotiations is that developing nations have let themselves bamboozled into accepting an agricultural-liberalization-centered agenda as a Development Round. In fact, the developing countries' interest in agricultural liberalization has always been ambiguous. Aside from a few middle-income members of the Cairns group, such as Argentina, Brazil, Chile and Thailand, which are important agricultural exporters, few developing countries have traditionally looked at this area as a major source of gain. Research done at the World Bank during the Uruguay Round had highlighted the possibility that most Sub-Saharan African nations could actually end up worse off as a result of the rise in world food prices produced by the reduction in European export subsidies. More recently, a range of careful, microeconomic studies have shown that the poverty impact of increases in relative agricultural prices tends to be heterogenous and uncertain, even for the producers themselves.

Moreover, most global trade models predict very modest increases in agricultural prices—increases that are likely to be swamped by the sheer volatility in commodity prices. Consider cotton for example. The largest estimate of the price impact of the eventual and complete removal of U.S. cotton subsidies is around 15%. Compare this to the impact of the devaluation of the CFA Franc in 1994 by 50%, which in principle should have raised agricultural incomes in countries such as Burkina Faso and Benin by a full 50%. There is little evidence that such a boost in incomes actually took place, however, since the most direct beneficiaries of increases in border prices tend to be

traders and intermediaries, rather than farmers. In all likelihood, poor farmers will reap very few of the gains generated by agricultural liberalization in the North. The real winners will be taxpayers and consumers in the North and traders and intermediaries in the South.

Indeed, the reason that agriculture figures so heavily on the negotiating agenda has little to do with development. Agriculture got transformed into a development issue thanks to the skillful maneuvering of the USTR and then WTO director general Mike Moore, as a way to bring Europe to the negotiating table by capturing the high moral ground. Europe in turn asked for the Singapore issues to be included on the agenda as a quid pro quo, adding insult to injury where developing countries are concerned.

### Where the gains really are

If trade negotiators were genuinely interested in devising market-access rules that benefit developing countries, they would focus not on agriculture but on something else entirely: temporary labor mobility. The greatest demonstrable gains to developing nations from relaxing restrictions in the world economy today lie in the liberalization of temporary labor flows. It is hard to identify any other issue in the global economy with comparable potential for raising income levels in poor countries while enhancing the efficiency of global resource allocation. Even a relatively small program of temporary work visas in the rich countries could generate income gains for workers from poor countries that exceed the predictions for all of the Doha proposals put together.

Consider for example a temporary work visa scheme that amounts to no more than 3 percent of the rich countries' labor force. Under the scheme, skilled and unskilled workers from poor nations would be allowed employment in the rich countries for 3-5 years, to be replaced by a new wave of inflows upon return to their home countries. A back-of-the-envelope calculation indicates that such a system would easily yield \$200 billion annually for the citizens of developing nations. The positive spillovers that the returnees would generate for their home countries—the experience, entrepreneurship, investment, and work ethic they would bring back with them and put to work—would add considerably to these gains. What is equally important, the economic benefits would accrue directly to workers from developing nations. We would not need to wait for trickle-down to do its job.

Is something like this politically feasible in the advanced countries? If substantial liberalization of trade and investment has taken place in rich countries, it is not because it has been popular with voters at home, but largely because the beneficiaries have organized successfully and become politically effective. Multinational firms and financial enterprises have been quick to see the link between enhanced market access abroad and increased profits, and they have managed to put these issues on the negotiating agenda. Temporary labor flows, by contrast, have not had a well-defined constituency in the advanced countries. This is not because the benefits are smaller, but because the beneficiaries are not as clearly identifiable. But political constraints can be malleable with appropriate leadership. President's Bush recent speech proposing a

temporary worker program for the U.S. is a very encouraging sign that the tide may be turning on this.

To ensure that labor mobility produces benefits for developing nations it is imperative that the regime be designed in a way that generates incentives for return to home countries. While remittances can be an important source of income support for poor families, they are generally unable to spark and sustain long-term economic development. Designing contract labor schemes that are truly temporary is tricky, but it can be done. Unlike previous such schemes, there need to be clear incentives for all parties—workers, employees, and home and host governments—to live up to their commitments. One possibility would be to withhold a portion of workers' earnings until return takes place. This forced saving scheme would also ensure to workers would come back home with a sizeable pool of resources to invest. In addition, there could be penalties for home governments whose nationals failed to comply with return requirements. For example, sending countries' quotas could be reduced in proportion to the numbers that fail to return. That would increase incentives for sending government to do their utmost to create a hospitable economic and political climate at home and to encourage their nationals' return.

In the end, it is inevitable that the return rate will fall short of 100 percent. But even with less than full compliance, the gains from reorienting our priorities towards the labor mobility agenda remain significant.

#### The importance of policy space

A second area of fundamental interest to developing countries is policy autonomy. WTO rules must recognize that poor countries need the space within which they can pursue developmental policies. In fact, policy space is good not only for development, it is also good for trade. When developing countries can grow their economies, they can also expand their trade volumes.

Developing countries are currently short-changing themselves when they focus their complaints on specific asymmetries in market access (tariff peaks against developing country exports, industrial country protection in agriculture and textiles, etc.). They would be better served by pressing for changes that enshrine development at the top of the WTO agenda, and thereby provide them with a better mix of enhanced market access and room to pursue appropriate development strategies.

The secret of economic growth lies in institutional innovations that are country-specific, and that come out of local knowledge and experimentation. These innovations are typically targeted on domestic investors and are tailored to domestic realities. Accordingly, a development-friendly trading regime evaluates the demands of institutional reform not from the perspective of integration ("What do countries need to do to integrate?") but from that of development ("What do countries need to do achieve broad-based, equitable economic growth?").

Almost all successful cases of development in the last fifty years have been based on creative and often heterodox policy innovations. Countries like South Korea and Taiwan had to abide by few international constraints during their formative growth experience in the 1960s and 1970s. At the time, GATT rules were sparse and permissive. So these countries combined their outward orientation with unorthodox policies: high levels of tariff and non-tariff barriers, public ownership of large segments of banking and industry, export subsidies, domestic-content requirements, import-export linkages, patent and copyright infringements, directed credit, and restrictions on capital flows (including on DFI). Since the late 1970s, China also followed a highly unorthodox two-track strategy, violating practically every rule in the guidebook (including, most notably, the requirement of private property rights). India, which significantly raised its economic growth rate in the early 1980s, remained a highly protected economy until the late 1990s. Vietnam has followed a China-like strategy, and has achieved an impressive growth record without membership in the WTO.

In all of these countries, trade liberalization was a gradual process, drawn out over a period of decades rather than years. Significant import liberalization did not take place until after there had been a transition to high growth. And far from wiping the institutional slate clean, all of them managed to generate growth by creatively modifying existing institutions, imperfect as they may have been. That is why developing countries need to resist the encroachment of WTO disciplines on their ability to undertake divergent and heterodox policies.

#### Reconciling the interests of rich and poor nations

A trade regime that puts development first would accept institutional diversity and the right of countries to erect and protect their own institutional arrangements—so long as they do not seek to impose them on others. Once these principles are accepted and internalised in trade rules, priorities of poor nations and the industrial countries can be rendered compatible and mutually supportive. For example, a “development box” or “opt-out mechanism” could essentially extend the existing safeguard agreement to permit countries to restrict trade or suspend WTO obligations for reasons that include social and distributional goals as well as development priorities. This would require replacing the serious injury test with the need to demonstrate broad domestic support for the proposed measure among all relevant parties—including exporters and importers as well as consumer and public interest groups—and could be complemented by WTO monitoring as well as an automatic sunset clause.

One result of a shift to a development focus would be that developing nations would articulate their needs not in terms of market access, but in terms of the policy autonomy needed to exercise institutional innovations. Another is that the WTO would function to manage the interface between different national systems rather than to reduce national institutional differences.

Viewing the WTO as an institution that manages institutional diversity gets developing countries out of a negotiating conundrum that arises from the inconsistency between their

demands for flexibility to implement their development policies, on the one hand, and their complaints about Northern protectionism in agriculture, textiles, and labour and environmental standards, on the other. As long as the issues are viewed in market-access terms, developing countries will remain unable to defend their need for flexibility. And the only way they can gain enhanced market access is by restricting their own policy autonomy in exchange. Once the objective of the trade regime is viewed as letting different national economic systems prosper side by side--the debate can centre on each nation's institutional priorities and how they may be rendered compatible. This would also save developing countries precious political capital by obviating the need to bargain for "special and differential treatment"--a principle that in any case is more form than substance at this point.

Finally, the shift in focus provides a way to reconcile the perspectives of developing country governments, which complain about asymmetry in trade rules, and civil society organisations, primarily in the North, which charge that the system pays inadequate attention to values such as transparency, accountability, human rights and environmental sustainability. The often conflicting demands of these two groups--over issues such as labour and environmental standards or the transparency of the dispute settlement process--have paralysed the multilateral trade negotiation process and allowed the advanced industrial countries and the WTO leadership to seize the "middle" ground.

Tensions over these issues become manageable if the debate is couched in terms of development processes--broadly defined--instead of the requirements of market access. Viewing the trade regime--and the governance challenges it poses--from a development perspective makes clear that developing country governments and NGO critics share the same goals: policy autonomy, poverty alleviation, and environmentally sustainable human development.