Trade liberalization for development?

Jomo Kwame Sundaram and Anis Chowdhury
November 6, 2019 – *IDEAS*

The International Monetary Fund (IMF), the World Bank and the World Trade Organization (WTO), all dominated by rich countries, have long promoted trade liberalization as a 'win-win' solution for "all people—rich and poor—and all countries—developed and developing countries", arguing that "the gains are large enough to enable compensation to be provided to the losers".

Yet, the IMF's 2016 *World Economic Outlook* has warned that free trade is increasingly seen as only or mainly benefiting the well-off. The help and compensation needed by those disadvantaged by trade liberalization has rarely if ever been forthcoming, even in most developed economies.

Dubious claims

In 2001, World Bank research papers claimed a strong positive effect of trade for growth, arguing that globalization would accelerate growth and poverty reduction in poor countries. Similarly, a November 2001 IMF brief noted, "Integration into the world economy has proven a powerful means for countries to promote economic growth, development, and poverty reduction".

Earlier, its 1997 *World Economic Outlook* claimed, "Policies toward foreign trade are … promoting economic growth and convergence in developing countries." A host of Fund research papers likewise advocated trade liberalization.

However, surveying a large body of influential early research, Rodriguez and Rodrik concluded, "we are skeptical that there is a strong negative relationship in the data between trade barriers and economic growth…"

Likewise, the historical record since 1870 offers no support for claiming a positive growth-openness relationship before the 1970s – the correlation was, in fact, negative during 1920-1940.

Similarly, during 1990-2003, growth was not significantly correlated with any measure of national trade openness. After all, the effects of any national trade policy also depend on the trade policies of others, especially existing and potential trading partners.

Baldwin observed that general policy advice of openness should not imply "that no government interventions, such as selective production subsidies or controls on short-term capital movements, are appropriate at certain stages of development." He cautioned, "we must be careful in attributing … lowering of trade barriers as being a sufficient government action for accelerating the rate of economic growth."

Trump backlash

With US President Donald Trump attacking trade liberalization, the nature of the debate has changed. For him, trade liberalization mainly benefits large corporations which profit from producing abroad, depriving American workers of jobs and decent remuneration.

Trump's trade restrictions have reversed decades of uneven trade liberalization. By insisting on bilateral over plurilateral and especially multilateral free trade agreements (FTAs), he has undermined trade liberalization's advocates and their claims. With Trump, the US, erstwhile champion of freer trade, has become its nemesis.

This policy U-turn has not only strengthened earlier doubts about the ostensible benefits of trade liberalization, not only for American workers, but also for developing countries, who have long insisted that international trade gains and costs are unequally distributed among nations.

Trade liberalizers strike back

Growing scepticism about trade liberalization, even before Trump's election in late 2016, had rekindled the IMF-World Bank-WTO advocacy, e.g., in *Making Trade an Engine of Growth for All*, despite its acknowledgement that "trade is leaving too many individuals and communities behind, notably also in advanced economies."

Reinvigorating Trade and Inclusive Growth is also unpersuasive, with poorly substantiated patronizing assertions, as if preaching to the converted. For the trio, the backlash is due to ignorance and failure to better advertise the benefits of free trade. Their touching faith remained unshaken despite considerable evidence, including their own, qualifying their advocacy claims.

Instead of more nuanced, and credible advocacy of multilateral trade liberalization, unencumbered by intellectual property, investment and other non-trade agreements, they can only recommend targeted 'safety-nets' and pro-active 'labour market programmes' (e.g., retraining).

UNCTAD dissent

By contrast, UNCTAD's *Trade and Development Report 2018* focused, inter alia, on the 'Free Trade Delusion'. The World Input-Output Database suggests trade liberalization has favoured capital at the expense of labour.

Capital's share of export value added in manufacturing global value chains (GVCs) rose from 44.8% in 2000 to 47.8% in 2014. Exceptionally, China's labour share rose from 43.0% to 50.4%, underscoring how government policy can influence distributional outcomes.

Besides exporting primary commodities, by participating in GVCs, some developing countries now produce intermediate manufactures, typically with imported inputs and equipment. Meanwhile, South-South trade has also increased.

From the 1980s, much of international trade growth was contributed by East, including Southeast Asia, accounting for growing shares of world output and manufactured exports. By 2016, East Asia accounted for over two-thirds of manufactured exports by developing countries.

"Asia alone accounted for about 88 per cent of developing country gross exports of manufactures…, and for 93 per cent of South–South trade in manufactures, while East Asia alone accounted for 72 per cent of both."

Services: great new hope

UNCTAD's report acknowledges that services, particularly those enabled by digital technologies, offers new opportunities for development. However, while the trio claim that opening up e-commerce would generally lift living standards, ostensibly because medium and small enterprises would benefit, UNCTAD notes e-commerce is dominated by a few giant transnationals.

The advantages conferred by intellectual property monopolies, incumbency, resources, name recognition and 'network effects' favour 'winner-takes-all' outcomes, strengthening domination of e-commerce, software, payments and others by a few large corporations. In 2014, for example, the top 1% of exporting firms accounted for 57% of exports (besides oil, gas and services), the top 5% for more than 80%, and the top quarter for almost all.

'Big data', secured by providing services to users, have been very profitably used by 'free' digital service providers. By 2015, 17 digital giants accounted for a quarter of the market capitalization of the top 100 transnational corporations.

The UNCTAD report suggests three policy measures to address digital service providers' profitable abuse of 'big data'. First, privacy laws must require 'informed consent' before collecting and using data from digital users.

Second, appropriate 'anti-trust' and competition policy measures should minimize 'restrictive practices' and other such abuses by monopolies and oligopolies. Third, effective digital policies involving data localization, data management flows, technology transfer, custom duties on electronic transmissions and other such measures can help increase gains.

Development, not liberalization

Trade liberalization has undoubtedly had varied consequences, and may well undermine a country's development prospects, food security and more. With trade liberalization, the main benefits often chiefly accrue to powerful transnational corporations and their business partners.

Meanwhile, employment generated in developing countries has often been seen as being at the expense of rich country workers displaced by the internationalization of GVCs. In the face of such challenges, appropriate and pragmatic government interventions have helped increase gains, reduce costs and develop economies.

As UNCTAD highlights, "Developing countries will need to preserve, and possibly expand, their available policy space to implement an industrialization strategy". But such options for development diminish as economies liberalize indiscriminately, praying for the best.