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GLOBALIZATION AND THE CHANGING TRADE DEBATE

Suggestions for a New Agenda

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Globalization and the Changing Trade Debate

The failure of the Doha Development Round of World Trade Organization (WTO) negotiations in July 2006 represents an important event. Whereas there have been broad public protests against the current global trading system—Seattle in 1999, Cancun in 2003—this is the first full-blown collapse of a multilateral trade negotiating round since World War II. That collapse has created a significant opening for potentially repositioning the global trade debate.

The failure of the Doha round does not signify the end of trade multilateralism or a reversion to protectionism. Rather, it marks the close of a 60-year era of trade policy largely centered on increasing market access and reducing tariffs, quotas, and subsidies. Behind this change is the growing recognition that international trade is a critical element of globalization, and that globalization is a larger, more complicated policy project than merely facilitating cross-border flows of goods and services.

The new circumstance creates both opportunity and danger. The opportunity is to construct a fresh approach to trade that incorporates rules governing the parameters of global competition and mediating the integration of economies. Such rules can improve globalization by diminishing its impact on income distribution in developed countries, preventing race-to-the-bottom competition between all countries, and promoting sustainable economic development in developing

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countries. The danger is that this opportunity is not taken, in which case it is possible there could be a slide toward protectionism, particularly in the event of a deep global recession.

In effect, the failure of the Doha round signals the need for the creation of a 21st-century trade agenda that moves away from the traditional focus on trade liberalization to address questions of how to govern globalization. Successfully accomplishing this transition will require the formation of a new intellectual and political consensus.

Why Did Doha Collapse?

One reason why the Doha negotiations collapsed is that trade is complicated, and the simple nostrums of "free trade" and "comparative advantage" do not capture this complexity. In middle-income countries (such as Brazil and Argentina) and the large developing economies (such as India), there is an increasing sense that traditional "Doha-style" trade agreements potentially compromise their development strategies (i.e., domestically-based production).

In conjunction, there has been growing anxiety among industrialized-country electorates that traditional trade liberalization is driving an undesirable form of globalization that is identified with widening income inequality, wage stagnation at the bottom and middle of the wage distribution, and undesirable forms of competition predicated on the exploitation of workers and a disregard for the environment. A lack of political support for the Doha round was further reinforced by agricultural interests in both the United States and Europe that were unwilling to give up existing subsidies and price supports (e.g., in sectors such as sugar and cotton).

Lastly, nongovernmental organizations (NGOs) contributed to derailing Doha by unmasking the excessive claims about the economic benefits of greater trade liberalization made by the international financial institutions (e.g., the World Bank) and mainstream economists.[1]

What Now?

The mainstream press has published much commentary about the threat that Doha's failure poses to the multilateral trading system. The commentary misconstrues both the causes and the consequences of this failure. Rather than signaling a threat to international trade and the global economy, Doha's demise represents an opportunity to reposition the global trade debate. Taking advantage of this opportunity will require a twin-track strategy: (1) developing an affirmative alternative trade agenda that is intellectually coherent and politically compelling; and (2) exposing the faulty economics of the existing policy paradigm.

A critical element of a new agenda is the need to premise the trade debate on the recognition that trade is an instrument, and not the ultimate goal, of policy. The real policy goal is economic development in the context of a fair, inclusive, and politically acceptable globalization.

Challenging the Current WTO Paradigm

It is critical to continue exposing the failings of the neoliberal model of economic development that underlies the current WTO paradigm. This is a difficult task, because the model is appealingly simple, with its "one-size-fits-all" approach to policy and its alleged win-win outcomes for both the individual country and the global economy that continue to pull policy in undesirable directions.

The economic record shows that the neoliberal policy mix has not delivered—witness Latin America, which applied the neoliberal Washington Consensus most radically and yet grew more slowly in the post-1980 Consensus era (Ocampo 2002). Detailed statistical work by Rodrik and Rodriguez (2001) challenges the hypothesis that international trade spurs development, and instead suggests that countries that develop successfully become successful traders.

Another means of challenging the current paradigm involves the estimation of the size of the welfare gains from further WTO-style trade liberalizations. One reason for Doha's failure was that the proposed trade liberalizations produced relatively small global economic gains, and those gains accrued to the developed-country bloc. There were also a number of significant net losers at the individual developing-country level (Polaski 2006).

A third form of challenge concerns the economic theory used to justify and drive the WTO's trade-liberalization agenda. That agenda is justified by appeal to the classical theory of free trade, which is predicated upon the logic of comparative advantage—a principle that no longer captures what is happening in the global economy. Trade driven by global outsourcing rests on the new structures of global production organized by multinational companies and retailing giants such as Wal-Mart, and these structures have changed both the character and the margins of global economic competition (Palley 2007). In today's world, where technology and methods of production are highly mobile, winning at trade involves strategic policy—which includes industrial policy, exchange rate policy, and tariffs. New theoretical arguments for such policy (Gomory and Baumol 2000; Samuelson 2004; Palley 2006a) are supported by economic history that shows that free trade was not the route chosen by industrialized countries in their early stages of economic development (Chang 2002).

Lastly, it is important not to be deceived by proposals that call for simply augmenting the Doha trade agenda with a new "helping hand" domestic policy agenda (Kletzer and Rosen 2005). Wage insurance, for example, does nothing to address the fundamental failings of current trade policy, which rests on flawed economic logic. The only comprehensive solution to the trade problem is a new trade regime.

Domestic Demand-led Development and Labor Standards

Over the last two decades, economic policy has focused on international trade and growing the supply side, but policy has neglected the development of domestic demand (Palley 2002, 2006b). This neglect has likely slowed growth and made it more unequal between developed and developing countries.

The focus on international competitiveness has encouraged holding down costs and, therefore, wages, and this focus has encouraged retrograde competition and contributed to destabilizing deflationary conditions in the global economy. Countries have added to global supply through export-led growth without similarly adding to global demand (Blecker and Razmi 2005; Palley 2003a).

Developing the demand side leads to a more inclusive agenda, as wage income becomes a critical source of demand. Linking wages to productivity can then promote a virtuous circle of inclusive development. Higher productivity drives higher wages, which in turn increase demand to absorb the increase in productivity. At the same time, robust demand conditions encourage producers to invest, further raising productivity and advancing development.

Labor standards are key for such a demand-led model of development, since they help workers bargain for a fair share of productivity (Palley 2004, 2005) and are critical to establishing a floor for the global economy. Additionally, labor standards can mitigate competition between southern hemisphere workers and help them capture a larger share of income. This can counter changes in the global production value chain that have seen value increasingly shifted to northern hemisphere economies, where it is captured at the retail end by companies such as Wal-Mart, Nike, and Gap.[2]

Labor standards give workers the right to form unions, and unions are essential to developing a demand-led system of economic growth. All developed economies embraced trade unions as part of their transformation to mature developed-market status. Trade unions are the "market-friendly" approach to correcting labor market failure, since unions set wages in a decentralized fashion and help establish a sustainable income distribution tied to underlying productivity that can support a consumer society.[3]

Tariffs and Industrial Policy

A post-Doha agenda must permit developing countries to use tariffs and industrial policy as part of their economic development policy toolbox. That suggests a narrower, more targeted trade agenda in which tariffs are lowered in some areas and strategically maintained in others.

For many developing countries, tariff revenues are also needed to fund public investment and services that are vital for development. Additionally, tariffs and industrial policy have proven to be a valuable tool for promoting growth (O'Rourke 2000). However, since capital-goods tariffs make a country less competitive and hinder development by increasing the costs of production, the policy focus should be on consumption goods tariffs.

Policy Space, Governance, and Labor Standards

The need to restore a role for tariffs and industrial policy links with broader concerns about autonomous national policy and how globalization is shrinking "policy space." As capital becomes more mobile and policy works both to lower barriers between economies and to synchronize rules across countries, the space for autonomous national policy seems to be shrinking. Reestablishing a role for tariffs and industrial policy can contribute to restoring policy space, but that requires good governance—which links back to the need for labor standards.

Not only do labor standards yield significant conventional economic benefits for developing countries and the global economy, they also yield significant political benefits in terms of democracy and better governance (Palley 2005). Linking trade with labor standards can therefore ensure that trade serves to promote both development and good governance. This means that labor standards must be the bedrock of a 21st-century trade agenda aimed at refashioning globalization.

Advancing this agenda will require a multifaceted approach. At the national level, trade negotiators should make labor standards an official policy priority to be pushed in all multilateral and regional forums. Labor standards should also be included in bilateral trade arrangements. Most importantly, there is a need to change the climate of opinion about labor standards, and to build a global echo chamber supporting them; the International Monetary Fund and the World Bank must endorse such standards, and NGOs must lobby governments and multilateral institutions to make them part of the rules of the global economy.

Environmental Standards

There is also a need for international environmental standards, particularly regarding greenhouse gases and global warming. Best of all would be the adoption of common, binding standards across countries. However, in the absence of common standards, countries will need to have the right to border-adjust for pollution costs that have international impacts.[4] The mechanism of protection is simple: imports from countries with low standards would face a tariff equal to the international environmental costs of production, thereby stripping away any competitive advantage achieved through environmental degradation.

Exchange Rates and Trade

Historically, exchange rates have not been considered part of trade policy, and they have been excluded from the rules governing international trade. However, exchange rates have both temporary effects on trade patterns and permanent long-run effects by influencing the location of industries (Gomory and Baumol 2000; Palley 2003b, 2006a). Moreover, these influences have become larger and more significant in the era of globalization, because economies are more open and production is more mobile.

Trade policy has yet to catch up with this fact, and still operates as if trade and exchange rates were separate. In the United States, this policy failure is evident in the trade deficit with China, which has been pursuing a policy of export-led growth that relies on an undervalued exchange rate. The result has been a tidal wave of imports from China into the United States, closure of U.S. manufacturing plants that compete with Chinese goods, and the relocation of production and new investment to China. The U.S.-China trade agreement gives China access to U.S. markets without any provisions guarding against the use of undervalued exchange rates to gain market share. This situation is unsustainable and could potentially generate a trade war.

In the era of globalization, exchange rates matter more than ever—which means that exchange-rate issues and disputes are likely to recur. The global trading system could collapse in a flurry of recriminations over unfair trade deficits and the resulting job losses, or be drawn into a round of competitive devaluation among countries, which in turn could produce financial turmoil and economic dislocation reminiscent of the 1930s. Guarding against these risks requires rules governing exchange rates, in addition to some form of global system of exchange-rate management.

A "Tropical Products" Trade Round of Trade Liberalization

Reframing the global trade agenda is likely to take time and to be contentious. In the meantime, there is room for small-scale, targeted multilateral trade liberalization that advances development in the southern hemisphere while producing benefits in the northern hemisphere. One suggestion is a tropical-products trade round involving commodities such as sugar, cotton, coffee, cocoa, rice, and orange juice (Palley 2006c). Such a trade round could focus on those commodities that are most beneficial to developing countries and those (northern) subsidies that are most damaging. Trade predicated upon the theory of comparative advantage still holds for these commodities, and there are trade gains to be had by all sides.

The advantages of a tropical-products trade round are numerous. First, it would refute the charge that opponents of the Doha round are opposed to trade in general. Second, it would truly help the world's poorest countries. Third, it would reduce northern production of tropical products (e.g., cotton and sugar) that compete with southern production, so that any induced price increases would raise southern incomes.

In this regard, a tropical-products trade round that involves sugar products, including ethanol, promises particularly clear economic and environmental benefits. Current U.S. policy imposes a stiff tariff on Brazilian sugar-based ethanol, which is the cheapest form of the fuel. That tariff has encouraged production of U.S. corn-based ethanol, increasing U.S. demand for corn and driving up corn prices. That in turn has caused an increase in food prices and contributed to higher inflation, which has hurt consumers and the economy. Removing the tariff on imported sugar-based ethanol provides a clear example of how a tropical-products trade round could generate win-win outcomes.

More generally, there are good economic reasons for northern countries to support such a round. First, eliminating certain specific agricultural subsidies would result in large government budget savings to northern taxpayers. Second, consumers would gain, as prices decline with the elimination of quotas. Third, northern manufacturing workers would have no interest in opposing a tropical-products round since they would benefit as consumers and taxpayers, while manufacturing would essentially be off the (bargaining) table. Fourth, northern production of tropical products is often environmentally damaging (e.g., growing sugar cane on Florida's everglades). These producers are poorly positioned to block such an approach to trade liberalization, as they tend to be large agrobusinesses whose political profile is unappealing.

Politics and Ideas

In the public's mind, trade is now firmly connected to globalization, and trade and globalization are viewed as significantly responsible for wage stagnation, widening income inequality, and increased job insecurity. Public disenchantment with globalization and existing trade policy points to the need for a new policy paradigm that addresses the economic realities of trade and globalization.

That alternative paradigm, with its emphasis on labor and environmental standards, rules for exchange rates, and domestic demand-led development, is now clear to see. Trade policy must also be intimately linked with the financial markets, a reining in of extreme corporate power, and an understanding that trade impacts the character of competition, the socioeconomic structure, and policy space.

Notes

1. See, for example, Polaski (2006).
2. Gereffi (1994) provides a seminal analysis of global value chains and how the global sourcing strategies of U.S. retailers have shaped the distribution of value in the global economy. See also Hamilton (2005).
3. This contrasts with a government edict approach to wage setting. An edict-based approach can get income distribution right, but it is not sustainable because it is not linked to underlying productivities. Consequently, it results in mispricing and market distortions that disrupt and reduce economic activity because wages and prices are set incorrectly.
4. Such pollution can be distinguished from local pollution that only affects the locale or country of production. There is a clear economic rationale for border-adjusting the costs of international pollution since those costs fall on others. How to deal with local pollution is more complex, the claim being that countries have a right to choose how polluted they want their local environment to be so that local pollution should not be subject to international scrutiny and border adjustment.

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Palley has published in numerous journals, including the *Atlantic Monthly*, *American Prospect*, and *Nation* magazines. He is the author of *Plenty of Nothing: The Downsizing of the American Dream and the Case for Structural Keynesianism* (Princeton University Press 1998) and *Post Keynesian Economics* (Macmillan 1996). Some recent policy articles include "External Contradictions of the Chinese Development Model," *Journal of Contemporary China*, February 2006; "The Questionable Legacy of Alan Greenspan," *Challenge*, November/December 2005; "The Economic Case for International Labour Standards," *Cambridge Journal of Economics*, January 2004; and "Asset Price Bubbles and the Case for Asset-based Reserve Requirements," *Challenge*, May/June 2003.

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