A case for tailoring - and slowing - free trade in poor nations

By Robert B. Reich
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Fair Trade For All How Trade Can Promote Development By Joseph E. Stiglitz and Andrew Charlton 315 pages. Oxford University Press.

It is not exactly a new debate. On my bookshelf sits "Which? Protection or Free Trade," edited by H. W. Furber and published in Boston in 1888. That was some 70 years after the British economist David Ricardo first suggested that the gains from trade exceed the losses regardless of whether trading partners are more or less economically advanced, as each nation shifts to where it has a comparative advantage. Most economists and policy makers now accept Ricardo's argument, although the popular debate over the merits of free trade continues.

The new and more interesting debate is about how the benefits of trade should be shared. During the 1990s, the so-called Washington consensus of officials from the International Monetary Fund, World Bank and United States Treasury Department thought the best way to spur growth in developing nations was for them to quickly lower their trade barriers and deregulate their markets. But that prescription has not worked especially well, even though it still shapes American trade policy. Apart from China and India, the gap between rich and poor nations has continued to widen. More than two billion people worldwide live on the equivalent of less than a dollar a day. Trade talks initiated in Doha, Qatar, in 2001, were intended to redress the balance but have gone nowhere. The last major international meeting, in 2003 in Cancún, Mexico, ended in failure and recrimination, and there has been little progress since. The world's poorer nations think the richer ones are still offering a lousy deal.

In their provocative book, "Fair Trade for All," Joseph E. Stiglitz, a professor of economics at Columbia, and Andrew Charlton, a research officer at the London School of Economics, argue that the poorer nations are right. A better deal would be for them to move toward free trade gradually, each according to its own particular circumstances. The authors urge richer nations to help poorer ones prepare themselves for trade, while dismantling their own trade barriers, which prevent developing nations from selling them many goods and services. Stiglitz is worth listening to. A winner of the Nobel in economic science in 2001 for his pioneering work in the economics of information, he was a member and then chairman of the Council of Economic Advisers from 1993 to 1997 (during which time, in the interest of full disclosure, we frequently attended the same White House meetings), thereafter becoming chief economist and senior vice president of the World Bank. In other words, Stiglitz was in Washington when the Washington consensus was formed. He was a dissenter, however, and in recent years has been an outspoken critic of Washington's trade and global investment policies.

Stiglitz and Charlton show that standard economic assumptions are wrong when it comes to many developing economies. When markets in sub-Saharan Africa and elsewhere are opened, people often can't move easily to new industries where the nation has a comparative advantage.

Transportation systems that might get them there are often primitive, housing is inadequate and job training is scarce. They are vulnerable in the meantime because safety nets are weak or nonexistent. Most people lack access to credit or insurance because financial institutions are frail, so they are unable to start their own businesses or otherwise take advantage of new opportunities that trade might bring. Many poor countries are already plagued by high unemployment, and job losses in the newly traded sector might just add to it.

Hence, the authors argue, the pace at which poorer nations open their markets to trade should coincide with the development of new institutions - roads, schools, banks and the like - that make such transitions easier and generate real opportunities. Since many poor nations cannot afford the investments required to build these institutions, rich nations have a responsibility to help.

Without these other institutions in place, the authors say, trade by itself can do more harm than good. They point out that inequality increased after trade was liberalized in Argentina, Chile, Colombia, Costa Rica and Uruguay. Ten years after the North American Free Trade Agreement went into effect, Mexico's real wages are lower than they were before, and both inequality and poverty have grown. Many of the manufacturing jobs that came to Mexico in the wake of Nafta have since been lost to China, partly because China invested heavily in education and infrastructure while Mexico, lacking tariff revenues, could not afford to do so.

According to Stiglitz and Charlton, every developing country that has succeeded in achieving rapid growth has protected its market to some extent until it was ready to dismantle trade barriers.

Moreover, they warn, one size does not fit all. Richer nations should not force all poorer nations to abide by the same market-opening rules and timetables. Poorer nations have different needs. They are at different stages of economic development (subsistence agriculture in much of Africa and parts of Asia, export-oriented agriculture in Latin America and other parts of Asia, early-stage industrialization elsewhere). They have different political and institutional capacities.

Richer nations should also help developing nations get a fair share of the benefits of trade, Stiglitz and Charlton write, by reforming themselves. They should no longer protect their own textile producers, subsidize their farmers, shield their maritime and construction industries, or impose fines on poor nations for allegedly "dumping" exports at below-market rates. More broadly, the authors suggest, all nations that have joined the World Trade Organization should make a commitment to giving complete free-market access to all developing countries poorer and smaller than themselves.

Surprisingly, though Stiglitz has spent some years in Washington, he does not answer the obvious next question: How can this commendable agenda be sold to richer nations? Their political leaders are in a bind since so many of their own citizens are also losing jobs and experiencing declining incomes and, rightly or wrongly, blaming globalization for their plight. This is one of the major reasons the antiglobalization movement is as strong in the developed world as in the developing.

While Stiglitz and Charlton nobly assert that trade agreements should be viewed as presumptively unfair if they bestow disproportionate benefits on richer nations, they fail to acknowledge that within richer nations free trade is already disproportionately benefiting the best educated and best connected. The wealthy are growing much wealthier while the middle class is being squeezed. In fact, the adjustment mechanisms the authors find lacking in most developing economies - good public schools, modern infrastructure and adequate social safety nets - are coming to be less and less available even in the United States. Free trade surely generates the gains Ricardo claimed for it. But until those gains are more widely shared - within richer countries as well as between richer and poorer - we can kiss any further round of trade liberalization goodbye.

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