SouthViews
No.40, 7 November 2012

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Towards an alternative narrative for the multilateral trading system

The following is a presentation at the UNCTAD's Trade and Development Board panel discussion on 18 September by Ambassador Faizel Ismail, Permanent Representative of South Africa to the WTO.

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By Faizel Ismail

This presentation will argue that the recent attempts by some policy makers to use the concept of Global Value Chains (GVCs) to make a case for increased trade liberalization is deeply flawed for three reasons: First because it attempts to bring back the notion of a self-regulating market that is disembedded from society and divorced from the asymmetries in economic power that characterize today's interdependent global economy; Second, because it attempts to revive the discredited Washington Consensus; and third because it does not provide a framework for helping developing economies develop beyond their current comparative advantages. Consequently, this approach to trade liberalization we will argue is a false basis to re-invigorate the current Doha round and to deal with the crisis in multilateralism. We will attempt to provide an alternative and more sustainable basis to rebuild the multilateral trading system.

The mainstream view

The mainstream view on globalization and trade policy is currently driven by the Global Value Chains approach. The proponents of this approach argue that GVCs have created greater global integration and interdependence as TNCs have increasingly located their production across several countries and goods are "made in the world" rather than in a single country (WTO, 2011). As more and more value chains come to dominate global production, countries looking to increase their gains from trade are advised to reduce and remove all tariff and non-tariff barriers to the free flow of goods and services if they want to increase their opportunity to participate in GVCs and thereby to grow and develop (OECD, 2012).

Self-regulating market - Disembedded from society

The view of the global market as a self-regulating machine is divorced from the specific political, social and institutional structures and norms of societies. It is a utopian idea that was born in the nineteenth century. It is this same utopian logic of the self-regulating market that is now being advanced to make the case for what Dani Rodrik (Rodrik, 2011) describes as "hyper-globalization". However, as several writers have observed, economic processes and the market are embedded in social processes and conform to the social norms of society and reflects their specific historical experiences (Polanyi, 1944; Cox, 2002). Moreover, many of the proponents of this GVC approach almost totally divorce their analysis of globalization from the experiences of the majority of people in the world suffering the effects of a continuing economic and social crisis reflected in: rising unemployment, inequality and poverty.

"Even the most practical man of affairs is usually in the thrall of the ideas of some long dead economist", according to Keynes , the famous economist.

Many economists (from Raul Prebisch to Joseph Stiglitz) have critiqued the traditional theory developed by Paul Samuelson who argued that trade liberalization automatically leads to positive changes in welfare. In his critique Stiglitz observes that “the underlying assumptions that yield this conclusion are highly restrictive and often fail to reflect many of the relevant characteristics of developing countries” (Stiglitz, 2012). However, the idea that trade liberalization promotes growth and development has become an unquestioned assumption and rose to an ideology of the world trading system. This was a centerpiece of the discredited Washington Consensus. The dangers of protectionism of the 1930’s and its consequences was used to urge developing countries to keep liberalizing – the so-called bicycle theory of trade liberalization emerged (Wilkinson, 2012).

However, Stiglitz pointed to the double standards of some rich countries that were preaching one thing and doing another. In his book (Stiglitz, 2003) entitled “*The Roaring Nineties”,* Joseph Stiglitz argued that in the 1990s, the United States continued to advance this free-market “Washington Consensus” internationally, calling for free trade, de-regulated financial markets and the privatisation of state enterprises (bilaterally and through their influence in the Bretton Woods institutions and the WTO) and during the Uruguay Round he states that,…the U.S. pushed other countries to open up their markets to areas of our strength…but resisted efforts to reciprocate”. Other writers have shown that tariff measures were used by the most advanced countries well into the 20th Century, with the United States having the highest tariffs (Paul Bairoch,1993). These developed countries have been in denial of their own history especially when developed countries have tried to use these policies. This has been described as “kicking away the ladder” (Ha Joon Chang, 2012).

More recently, the current effects of protectionist measures have been exaggerated in several WTO/OECD reports to the G20 on trade restrictive measures. These reports have tended to include the use of all legitimate trade measures, such as AD and CVDs, as trade restrictive (see OECD, WTO, UNCTAD, 2012). These images of a world descending into protectionism the authors hope will have the effect of persuading countries to liberalize.

A new wave of industrial policy

Much of this policy narrative does not appear to be based on a careful empirical assessment of the links between GVCs and development. There is an implicit and often explicit assumption that more trade inevitably leads to development and that trade linked to GVCs has the added advantage of bringing spillovers of one kind or another from hosting those TNCs that organize such chains. However, over a decade ago UNCTADs’ Trade and Development Report (UNCTAD, 2002) already warned that participating in GVCs could involve "trading more but earning less". There was, moreover, little systematic evidence to suggest that technological and other spillovers were automatic inside these chains.

Developing countries – caught in a “commodities trap” – that wanted to increase the value of their production and diversify out of the low value end of basic commodity production needed policy space to develop policies to advance their industrialization. More recently discussions of a “middle income trap” have raised concerns that even for countries that have successfully entered the lower ends of the value chain the challenge of further diversification and upgrading can remain a difficult one.

Robert Wade (2012) has argued that in a world where technological change is the norm, parts of many industries in many economies will be “infants” at different times even in the most advanced economies, making the case for strategic trade and industrial policy all the more important. The GVCs approach by contrast, continues to place the emphasis on static efficiency gains, lowering transaction costs and providing a friendly business environment for attracting TNCs as the goals of trade policy and consequently putting the emphasis on removing social and economic regulations and restricting policy space for national development. Doing so not only circumscribes the scope for industrial policy but also fails to recognize the need for a more integrated approach to macroeconomic, trade and industrial policy in support of productive investment and economic diversification.

A recent paper by two Chinese scholars (Xinquan TU and LIN Guijun, 2012) also observes that there is a new wave of industrial policy with both the US and the EU actively seeking to design government led industrial strategy. The US they argue is already spending billions in innovation sectors such as renewable energy, high-speed rail and advanced vehicles. These scholars argue that in the context of the unfolding economic recovery in the US and EU and the slowdown of growth in the emerging economies, the use of industrial policies that are not trade distorting to help countries to recover and lift them out of the current recession may need to be accommodated by WTO rules.

The mercantilist lobbies argue for plurilateral approaches

It is not accidental that the leading proponents of the GVC approach are a group led by the US Services Coalition (CSI) that also influenced the discourse of the G20 Business Group (B20) recently held in Puerto Vallarta, Mexico on the margins of the G20 Trade Ministers meeting. The major US multinationals in the finance, logistics and telecoms sectors are now the main proponents of aggressive liberalization albeit they appear to have given up on the multilateral route and are now the driving force of the plurilateral and single issue approach as an alternative to the multilateral approach and single undertaking of the Doha round. Thus the effect of this aggressive liberalization proposed by the proponents of the GVC approach is to prefer a fast track plurilateral approach to trade opening rather than the slower multilateral and more inclusive approach.

I have argued that the main reason for the failure of the round is the aggressive and unrealistic market access demands of the major developed countries (Ismail, 2012). The crisis in the WTO negotiations is due to the paradox that whilst the majority of people – in developed and developing countries – are skeptical of the benefits of hyper-globalization – the major developed country players in the WTO have been pushing for aggressive trade liberalization. In addition those that are seeking to revive support for trade liberalization are basing their arguments on the GVCs approach which is attempting to reincarnate the mantra of trade liberalization and hyper-globalization as a solution to all our social and economic ills. Whilst some of the major TNCs in the US are demanding aggressive liberalization the dominant perspective across the political spectrum in the US believe that the gains from the Doha Round are too little and the adjustments and obligations required of the US will be too high. There appears to be an unusual bi-partisan consensus in the US today that the Doha round is dead – and that it does not serve US interests to pursue it in its current form and mandate.

The trading system remains inequitable

However, the inequities of the current trading regime remain a stark reminder of the ills of the past. LDCs, such as Bangladesh, remain discriminated and locked out of the major developed country markets. And developed country subsidies and high tariffs in Agriculture still distort world trade – the case of the African Cotton Four countries has become a litmus test for the legitimacy of the trading system. And new rules negotiated in the Uruguay Round, have reduced policy space for developing countries wishing to pursue their industrial development. The rules of the WTO are perceived to be biased in favour of the rich countries. The Doha round sought to address these issues in the Doha Development Agenda.

Systemic challenges of world trade are increasing!

Meanwhile new systemic challenges confront the world trading system. The distortionary impact of unregulated finance on the trading system, through, for example, exchange rate movements which dwarf changes in tariff regimes, are yet to be seriously addressed at the multilateral level. The need to develop alternative energy sources and the increasing use of measures such as border taxes to reduce carbon use will create a demand for new trade rules. High food prices have raised the spectre of food shortages and a demand for new rules on export taxes and export bans of food. The recent case on Rare Earths against China by the US, EU and Japan have raised the question of new rules on natural resources. The proliferation of transcontinental and non-continuous FTAs, especially the TPP are creating an increasingly fragmented global trading system. In addition the increasing proliferation of NTBs (including SPS and TBT standards and regulations) as new protectionist devices demand the need for clearer and more transparent disciplines and fast track dispute settlement mechanisms. All these issues demand the need for increased global cooperation.

Alternative conceptions of trade, development and multilateralism

A new approach to these challenges will need to be constructed as the limits of globalization become more apparent (Rodrik, 2011). In his new book, *The Globalization Paradox*, Dani Rodrik has argued that the world cannot simultaneously pursue democracy, national determination and economic globalization. He suggests that a thin layer of international rules that leaves a substantial room for maneouver by national governments – and that is consistent with the values and aspirations of different nations – will be more resilient.

In this context the challenge today is to construct an alternative analysis of the crisis of “actually existing” globalization rather than the theoretical versions of the prevailing fashion. An alternative narrative is required as the more appropriate policy response to this crisis at national levels both in developed and in developing countries. The GVC approach attempts to bring back a narrative of trade and the virtues of trade liberalization that was constructed to advance the interests of the US and EU. The GATT (and the WB/IMF) was the institutional embodiment of this narrative (Wilkinson, 2011). The challenge will be to construct an alternative narrative of trade and the multilateral trading system – one that speaks to challenges currently faced by millions of people in the world today – unemployment, poverty and inequality. The alternative approach to trade liberalization has to reconcile the need to avoid falling back into protectionist policies that lead to increased trade conflict whilst creating new economic opportunities for developing countries and fairer global trade rules.

Where should such an alternative analyses begin? We need to recognize that markets are not self-regulating, or a disembedded sector from society. Each national economy is different. It is embedded in a social context. Liberalizing trade therefore does not have the effect of creating new opportunities for all automatically by creating new efficiencies by reallocating resources from one sector to another. Trade liberalization must be seen as a tool for development.

In my book titled: *Reforming the WTO*, I argued that the WTO should make DEVELOPMENT the overarching objective of WTO rules and obligations. This will have the additional value of enabling coherence between the WTO and the UN where Development has long been recognized as the overall objective and guide of the UN as a whole.

In my second book, *Mainstreaming Development*, I set out four Dimensions of Development that I argued should become the principles that guide the WTO. This analysis draws on the work of Amartya Sen (Sen, 1999) who defines development as the process of expanding human freedoms.

First Principle: Fair Trade

To provide developing countries with economic opportunities to export in global markets, we have to create a level playing field. In Agriculture, we have to remove the distortions caused by subsidies in developed countries that prevent and undermine developing countries from pursuing their comparative advantage. Interestingly at a recent seminar at the Commonwealth Secretariat, Joseph Stiglitz argued for the introduction of the concept of the *Right to Trade* (Stiglitz, 2012). We agree with this. Whatever we do with the Doha Development Agenda we cannot ignore the reality of the current inequity that still prevails in the trading system: the plight of the four West African LDC cotton producers facing high trade distorting subsidies is a stark reminder of the inequity of the trading system.

Second Principle: Capacity Building

Poor countries can do little to take advantage of market access opportunities, when this is made available to them, if they do not have the capacity to produce, and export. Thus Sen has argued that poverty should be understood not so much as low incomes but as a deprivation of basic capabilities. The Hong Kong Ministerial Declaration (WTO, 2005) recognized the importance of "Aid for Trade" and called on the Director General of the WTO to a) create a Task Force that "shall provide recommendations on how to operationalize Aid for Trade, and b) to consult with members as well as the IMF and World Bank and other relevant international organizations "with a view to reporting to the General Council on appropriate mechanisms to secure additional financial resources for Aid for Trade". This Task Force submitted its recommendations to the General Council at the end of July 2006. However, a great deal still remains to be done to implement the recommendations of the task force; to provide additional aid for trade, to ensure the existing aid is effective, and there is ownership by the partner countries. Joseph Stiglitz has also argued that such an Aid for Trade facility that monitors and evaluates the effectiveness of Aid for Trade should be located in UNCTAD. We agree with this as well.

Third Principle: Balanced Rules

Thirdly, the rules of the trading system also need to be balanced; whilst strengthening a rules based system for all to benefit, it should provide sufficient flexibilities to prevent developing countries from bearing the cost of these rules. Whilst Sen argues for government regulation to enable markets to work more effectively, he states that a system of ethics, based on social justice is required to build vision and trust for the successful use of the market mechanism. It is even more important to recognize differences that exist in the social, economic and political relations and institutions of countries. Rule making should not seek to average out and impose external standards but recognize differences; applying the rules with flexibility and retaining policy space for development (Dani Rodrik, 2012).

Fourth Principle: Good Governance

Fourthly, the participation of developing countries in the negotiating process is crucial to ensure that they are engaged in negotiating the new rules in a fair and democratic manner. Sen argues that the deprivation of the opportunity to participate in crucial decisions regarding public affairs, is to deny people the right to develop.

In the early years of the GATT the participation of developing countries was merely procedural whilst the substantive decisions were taken by the major developed countries. This has changed in the Doha round as developing countries have become more organized, have built negotiating coalitions and are demanding to be heard and their interests to be addressed in the negotiations. However, some major players not accustomed to genuine participation by all are attempting to return to the old practices of negotiating only amongst some and hoping to then impose this on the rest – this is the so-called Plurilateral approach used in the Tokyo Round. Other observers frustrated at the need to address the complexity of negotiations in a multilateral setting based on consensus have argued for a short circuiting of democracy through the variable geometry approach where a small group of major players first shape the deal. In Sen's view participation is essential for development.

Conclusion

We have thus argued that the current mantra of GVCs approach and its underlying conception of a global market free of social, political and environmental constraints to advance the interests of specific mercantilist interests is not an appropriate reflection of the current reality. In addition its attempt to revive support for aggressive liberalization in rich countries, suffering high levels of unemployment and loss of jobs, and in poorer countries of the South still suffering from high levels of underemployment, will not succeed. Thus the only basis on which support can be gained for the revival of support for multilateral trade will be one that recognizes trade as a tool to advance the social and economic objectives of societies; one that recognizes the differences and diversity of these countries needs and interests and builds rules of cooperation that does not impede or undermine the policy space required by these countries to build their economies in both the south and the north. Above all a trading system that is perceived as being inequitable and undermines the development interest of its poorest members will not gain legitimacy.

A new narrative on how to re-build the multilateral trading system on a more sustainable basis can only succeed if it is based on the principles of Fair Trade, Capacity Building, Balanced Rules and Good Governance as we have argued above. Brainstorming this will need to draw on the experience and approaches being discussed in other institutions such as UNCTAD, ILO, and civil society. The WTO will therefore need to discuss these challenges within a broader and different framework from that of its current one that was developed for trade in goods and with a mercantilist approach driven by the interests of its main architects (the US and the EU)..

This article was published in the South Bulletin (26 October 2012).

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