

# The Global Governance of Trade

As If

Development

Really Mattered

Dani Rodrik

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UNITED NATIONS DEVELOPMENT PROGRAMME

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Social Development Group  
Bureau for Development Policy  
United Nations Development Programme  
One UN Plaza, 20<sup>th</sup> floor  
New York, NY 10017  
<http://www.undp.org/bdp>

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Background papers are designed to generate discussion and feedback on issues of trade and sustainable human development for a series of consultations culminating in the UNDP Trade and Human Development Report in 2002.

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## About the Author

**Dani Rodrik** is the Rafiq Hariri Professor of International Political Economy at the John F. Kennedy School of Government, Harvard University. He has published widely in the areas of international economics, economic development, and political economy. What constitutes good economic policy and why some governments are better than others in adopting it are the central questions on which his research focuses.

Rodrik is the research coordinator of the Group of 24 (G-24), and is also affiliated with the National Bureau of Economic Research and the Centre for Economic Policy Research (London). He is the recipient of a Carnegie Scholar award for 2001, and his work has been supported also by the Ford and Rockefeller Foundations. He is the faculty chair of the new MPA in International Development (MPAID) degree programme at Harvard. He holds a Ph.D. in economics and an MPA from Princeton University, and an A.B. from Harvard College.

## Preface

Events surrounding the WTO Ministerial meeting in Seattle in late 1999 became a kind of Rorschach test for how different constituencies view globalization—how different people and groups look at the same pictures but draw different meanings from them. Many developing country governments noted the asymmetry in the multilateral trading regime, which they viewed as dominated by a narrow agenda of a few industrialized countries, thereby marginalizing the genuine development concerns of the vast majority of the people. Civil society organizations (CSOs) from both the South and North, for their part, were equally upset that their constituencies' many concerns were once again excluded from the intergovernmental discussions and negotiations.

The breakdown in Seattle opened up the opportunity for a much-needed breathing space to discuss and debate the significance of trade for achieving the Millennium Development Goals (MDGs). The controversy surrounding the global trading system is not about whether trade is necessary, but about how the multilateral trade regime can operate in ways that support and foster human development.

As the dust settled on Seattle, we were convinced that given UNDP's vanguard role in advocating for human development and its 1999 Human Development Report on Globalization, our organization had a special responsibility to contribute to the trade debate. Our response was to conceptualize, design and implement a project, which came to be known as UNDP's Trade and Sustainable Human Development project.

The project was approved in June 2000 and has four main phases; first, the commissioning of several respected scholars and experts to write consultant papers on different aspects of trade and its global governance from a human development perspective; second, the convening of an advisory team of concerned and internationally respected government trade negotiators and diplomats, academics, civil society activists and senior UN colleagues to critically assess the consultant paper outlines and advise on the overall project strategy; third, the use of the draft papers as inputs into a series of consultations with both developing country governments and civil society organizations, both to obtain their feedback on them and understand their concerns more fully; and last but not least, drawing upon all of these and other inputs, to prepare a UNDP report tentatively entitled 'Trade and Sustainable Human Development.'

The UNDP project has had three interrelated objectives:

- To assist developing country governments and civil society organizations in ensuring that their countries can selectively and strategically seize the opportunities of global economic and trade integration for advancing national progress in human development and poverty eradication;
- To strengthen the participation and substantive negotiating and advocacy posi-

tions of developing countries in the debate and negotiations on the emerging global trading regime;

- To present a UNDP position on the human development outcomes of the current global trading regime and the reforms needed to make it more inclusive and balanced, thereby enabling trade to become an instrument for enhancing human development and reducing poverty.

While consultations continue and UNDP's report is under preparation, the three consultant papers commissioned as part of the project are being made available. Indeed, an important part of the commitment of the project was to publish, in their independent right, each of the papers. We believe that they deserve to be widely read and used to inform the current debate on trade and development.

This paper, by Professor Dani Rodrik of Harvard University, analyses the global governance of trade from a development perspective. Professor Rodrik looks at trade through a development lens, with particular emphasis on assessing the relationship between trade, growth and poverty. He provides an analysis of the strengths and weaknesses of the existing trading system. The assumptions underlying trade liberalization and its relationship with growth and poverty are critically analysed. Based on the evidence, the paper makes proposals for how the multilateral trade regime and its agreements and practices need to change to better serve the goals of human development. The paper makes suggestions to developing countries on a range of pertinent issues, including on the crucial question of the degree of trade openness which is likely to be consistent with development objectives and outcomes under different country circumstances.

We hope the reader will find the paper informative and useful as a contribution to the ongoing debate on trade and development.



Eimi Watanabe  
Assistant Administrator and Director  
Bureau for Development Policy  
UNDP  
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## Executive Summary

It is widely accepted, not least in the agreement establishing the World Trade Organization (WTO), that the purpose of the world trade regime is to raise living standards all around the world—rather than to maximize trade per se. Increasingly, however, the WTO and multilateral lending agencies have come to view these two goals—promoting development and maximizing trade—as synonymous, to the point where the latter 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 maximize development potential, particularly that of the poorest nations in the world. Instead of asking, ‘How do we maximize 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?

The answer depends on how one interprets recent economic history and the role that trade openness plays in the course of economic development. The prevailing view in G7 capitals and multilateral lending agencies is that economic growth is dependent upon integration into the global economy. Successful integration in turn requires both enhanced market access in the advanced industrial countries and a range of institutional reforms at home (ranging from legal and administrative reform to safety nets) to render economic openness viable and growth-promoting. This can be called the ‘enlightened standard view’—enlightened because of its recognition that there is more to integration than simply lowering tariff and non-tariff barriers to trade, and standard because it represents the conventional wisdom. In this conception, the WTO’s focus on expanding market access and deepening integration through the harmonization of a wide range of ‘trade-related’ practices is precisely what development requires.

This paper presents an alternative account of economic development, one which questions the centrality of trade and trade policy and emphasizes instead the critical role of domestic institutional innovations. It argues that economic growth is rarely sparked by imported blueprints and opening up the economy is hardly ever critical at the outset. Initial reforms instead tend to combine unconventional institutional innovations with some elements from the orthodox recipe. They are country-specific, based on local knowledge and experimentation. They are targeted to domestic investors and tailored to domestic institutional realities.

A reinvigorated focus on development and poverty reduction, along with an empirically based understanding of the development process, would have far-reaching implications for the manner in which the international trading regime and the WTO function. This paper makes the case for such a reorientation, arguing that developing countries are 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.

### **Growth vs. Poverty Reduction**

The paper first takes up the debate about whether growth or poverty reduction strategies yield the greatest benefits, and argues that the distinction is not significant, since policies targeted at the poor generally tend to have growth payoffs. Even so, poverty reduction is a worthwhile policy goal in itself, for three reasons: 1) growth is not a sufficient measure of social welfare, since it ignores both the level and distribution of income, and competing growth strategies may have different payoffs for the poor; 2) interventions to help the poor may be the best way to raise average incomes, since they seek to close gaps between private and social costs; and 3) policies that target poverty reduction seek to maximize people's capabilities, including those of the poor, thus contributing to more sustainable development. The problem with current trade rules is not that they over-emphasize trade and growth at the expense of poverty reduction, but that they over-emphasize trade at the expense of poverty reduction *and* growth.

### **Alternative Development Strategies**

Turning to the determinants of economic growth, the paper discusses the enlightened standard view, which grew out of the failures of the Washington Consensus policies of the 1980s and 1990s. This view goes beyond liberalization and privatization to include the need for financial regulation and supervision, legal and administrative reform, labour market flexibility and social safety nets. Its reforms, however, are biased towards an Anglo-American conception of institutional soundness and are driven largely by the requirements of integration into the world economy. Needed instead is an approach that emphasizes domestic institutional innovations (comprising a mix of orthodoxy with 'local heresies') and of investment strategies tailored to each country.

This argument is supported by an examination of three types of successful development strategies: 1) import substitution strategies, based on (temporary) import protection for home producers, as done successfully in scores of developing countries during the 1960s and early 1970s; 2) outward oriented industrialization strategies, as pursued by the East Asian tigers in the 1980s, in which export led growth was made possible by government support of private investment, including credit subsidies, tax incentives, duty free access to inputs and capital goods as well as educational and infrastructural development; and 3) two-track reform strategies, as pursued for example by China and Mauritius in the late 1970s, that combine market liberalization and state regulation in different ways.

### **Trade Liberalization, Growth and Poverty Reduction**

The third section examines the literature on trade policy and economic performance, which forms the basis for the oft-heard statements on the benefits of trade openness, and concludes that there is no convincing evidence that trade liberalization is predictably associated with subsequent economic growth. The claims for such links arise from the misattribution of macroeconomic phenomena (overvalued currencies, macroeconomic instability), institutional

failures, or geographical location to trade policies. The only systematic relationship is that countries dismantle trade restrictions as they get richer, which accounts for the fact that most of today's rich countries embarked on economic growth behind protective barriers, which they subsequently lowered. This raises serious questions about the priority placed on integrationist policies in orthodox reform programmes. The problem is not trade liberalization per se, but the diversion of financial resources and political capital from more urgent development priorities.

To elaborate this point, the paper next presents some trade-offs faced by developing countries in deciding to implement WTO agreements, which reflect little concern for needed development priorities. Bilateral and regional trade agreements are often worse in terms of the obligations required in exchange for enhanced market access. Moreover, their emphasis on eliminating the state from the formulation or regulation of economic policy undermines state capacity to undertake the institutional reforms necessary to benefit from global integration.

### **General Principles**

The final section of the paper develops some general principles for a world trade regime that puts development first. Such a regime would accept institutional diversity and the right of countries to 'protect' their institutional arrangements—so long as they do not seek to impose it on others. Once these principles are accepted and internalized in trade rules, priorities of poor nations and the industrial countries can be rendered compatible and mutually supportive. An 'opt-out mechanism' would 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.

The WTO is devoted largely to bargaining over market access. 'Free trade' is not the typical outcome of this process; nor is consumer welfare what negotiators prioritize. Instead, the negotiating agenda has been shaped in response to a tug-of-war between exporters and multinational corporations in the advanced industrial countries on one side, and import-competing interests (typically, but not solely, labour) on the other. The differential treatment of manufactures and agriculture, or of clothing and other goods within manufacturing, the anti-dumping regime, and the intellectual property rights (IPR) regime, for example, are all a result of this *political* process. There is little in the structure of the negotiations to ensure that their outcomes are consistent with development goals, let alone that they seek to further development.

One result of a shift to a development focus would be that developing nations 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 should function to manage the interface between different national systems rather than to reduce national institutional differences. The most obvious advantage would be a more development-friendly international economic environment. Countries would be able to use trade as a means for development,

rather than being forced to view trade as an end in itself (and thereby sacrifice development goals). It would 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.

In addition, viewing the WTO as managing 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.

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 organizations, 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 paralyzed 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 reduction, and environmentally sustainable human development.

## The Global Governance of Trade As If Development Really Mattered

### Introduction

What objectives does (or should) the World Trade Organization (WTO) serve? The first substantive paragraph of the Agreement establishing the WTO lists the following aspirations:

raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development. (WTO 1995:9)

A subsequent paragraph cites 'mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations' as a means of 'contributing to these objectives' (ibid.). It is clear from this preamble that the WTO's framers placed priority on raising standards of living and on sustainable development. Expanding trade was viewed as a means towards that end, rather than an end in itself. Recently, promoting economic development has acquired an even higher standing in the official rhetoric of the WTO, partly in response to its critics.<sup>1</sup>

That the purpose of the world trade regime is to raise living standards all around the world—rather than to maximize trade per se—has never been controversial. In practice, however, these two goals—promoting development and maximizing trade—have increasingly come to be viewed as synonymous by the WTO and multilateral lending agencies, to the point where the latter easily substitutes for the former. As the WTO's Mike Moore (2000) puts it, 'the surest way to do more to help the poor is to continue to open markets.' This view has the apparent merit that it is backed by a voluminous empirical literature that identifies trade as a key determinant of economic growth. It also fits nicely with the traditional *modus operandi* of the WTO, which is to focus predominantly on

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reciprocal market access (instead of development-friendly trade rules). However, the net result is a confounding of ends and means. Trade becomes the lens through which development is perceived, rather than the other way around.

Imagine a trading regime that is true to the WTO preamble, one in which trade rules are determined so as to maximize development potential, particularly of the world's poorest nations. Instead of asking, 'How do we maximize trade and market access?' negotiators would ask, 'How do we enable countries to grow out of poverty?' Would such a regime look different from the one that exists currently?

The answer depends on how one interprets recent economic history and the role that trade openness plays in the course of economic development. The prevailing view in G7 capitals and multilateral lending agencies is that integration into the global economy is an essential determinant of economic growth. Successful integration in turn requires both enhanced market access in the advanced industrial countries and a range of institutional reforms at home (ranging from legal and administrative reform to safety nets) to render economic openness viable and growth promoting. This can be regarded as the 'enlightened standard view'—enlightened because of its recognition that there is more to integration than simply lowering tariff and non-tariff barriers to trade, and standard because it represents the prevailing conventional wisdom (see World Bank/IMF 2000). In this conception, today's WTO represents what the doctor ordered: the focus on expanding market access and deepening integration through the harmonization of a wide range of 'trade-related' practices is precisely what development requires.

This paper presents an alternative account of economic development, one that questions the centrality of trade and trade policy and emphasizes instead the critical role of domestic institutional innovations that often depart from prevailing orthodoxy. In this view, transitions to high economic growth are rarely sparked by blueprints imported from abroad. Opening up the economy is hardly ever a key factor at the outset. The initiating reforms instead tend to be a combination of unconventional institutional innovations with some of the elements drawn from the orthodox recipe. These combinations tend to be country-specific, requiring local knowledge and experimentation for successful implementation. They are targeted on domestic investors and tailored to domestic institutional realities.

In this alternative view, a development-friendly international trading regime is one that does much more than enhance poor countries' access to markets in the advanced industrial countries. It is one that enables poor countries to experiment with institutional arrangements and leaves room for them to devise their own, possibly divergent solutions to the developmental bottlenecks that they face. It is one that evaluates the demands of institutional reform not from the perspective of integration ('What do countries need to do to integrate?') but from the perspective of development ('What do countries need to do to achieve broad-based, equitable economic growth?'). In this vision, the WTO would no longer serve as an instrument for the harmonization of economic policies and practices across countries, but become an organization that manages the interface between different national practices and institutions.

This paper argues that a renewed focus on development and poverty reduction,

along with an empirically-based understanding of the development process, would have far-reaching implications for the way in which the international trading regime and the WTO function. It focuses on broad principles, rather than specific recommendations, because it is only through a change in the overall perspective of trade negotiations that significant change can be accomplished.

One of the key propositions is that developing countries are 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.). This approach reflects acceptance of a market-access perspective that does developing countries limited good. They would be far better served by pressing for changes that enshrine development at the top of the WTO agenda, and correspondingly provide them with a better mix of enhanced market access and manoeuvring room to pursue appropriate development strategies.

Since this paper is as much about the approach to development that should inform views about the international trade regime as it is about the WTO itself, much of the discussion is devoted to the empirical content of these ideas. The paper begins with an assertion that the distinction between development strategies that focus on growth versus those that focus on poverty reduction is a false one, since in practice, the two ends are inseparable. The main strike against existing trade rules is not that they over-emphasize trade and growth at the expense of poverty reduction, but that they over-emphasize trade at the expense of poverty reduction *and* growth. It then argues that the enlightened standard development model encompasses an impossibly broad and unfocused development agenda, and one that is biased towards a particular set of institutional arrangements. It emphasizes instead the centrality of domestic institutional innovations (comprising a mix of orthodoxy with 'local heresies') and of investment strategies that are tailored to the circumstances of each country.

Much of the paper focuses on the link between trade policy and economic performance. The voluminous literature in this area, which forms the basis for the oft-heard claims to the benefits of trade openness, is, upon examination, less unequivocal. A close look reveals that there is no convincing evidence that trade liberalization is predictably associated with subsequent economic growth. This raises serious questions about the priority that the integrationist policy agenda typically receives in orthodox reform programmes. The problem is not trade liberalization per se, but the diversion of financial resources and political capital from more urgent and deserving developmental priorities.

Finally, the paper offers some general principles for a world trade regime that puts development first. First, the trade regime must accept, rather than seek to eliminate, institutional diversity, along with the right of countries to 'protect' their institutional arrangements. However, the right to protect one's own social arrangements is distinct from, and does not extend to, the right to impose it on others. Once these simple principles are accepted and internalized in trade rules, developmental priorities of poor nations and the needs of the industrial countries can be rendered compatible and mutually supportive.

### **Growth versus Poverty Reduction: A Meaningless Debate**

Should governments pursue economic growth first and foremost, or should they focus on poverty reduction? Recent debate on this question has become embroiled in broader political controversies on globalization and its impact on developing economies. Critics of the WTO often take it to task for being overly concerned about the level of economic activity (and its growth) at the expense of poverty reduction. Supporters argue that expanded trade and higher economic growth are the best ways to reduce poverty. This largely sterile debate merely diverts attention from the real issues. In practice, economic growth and poverty reduction do tend to correlate very closely. However, the real question is (or ought to be) whether open trade policies are a reliable mechanism for generating self-sustaining growth *and* poverty reduction, the evidence for which is far less convincing.

Regarding the relationship between growth and poverty reduction, let's take some of the easier questions. Does growth benefit the poor? Yes, in general. The absolute number of people living in poverty has dropped in all of the developing countries that have sustained rapid growth over the past few decades. In theory, a country could enjoy a high average growth rate without any benefit to its poorest households, if income disparities grew significantly—that is, if the rich got richer while the incomes of the poor stagnated or declined. This is unlikely, however; income distribution tends to be stable over time, and rarely changes so much that the poor would experience an absolute decline in incomes while average incomes grow in a sustained fashion.

Moreover, to the extent that income distribution changes, its relationship to economic growth varies from country to country. Growth has been accompanied by greater equality of income in the Taiwan Province of China, Bangladesh and Egypt, for example, but by greater inequality in Chile, China and Poland. This suggests that the magnitude of the poverty-reduction payoff from growth depends, in part, on a country's specific circumstances and policies.

Is poverty reduction good for growth? Again, yes, in general. It is hard to think of countries where a large decrease in the absolute number of people living in poverty has not been accompanied by faster growth. Just as we can imagine growth occurring without any reduction of poverty, we can also imagine a strategy of poverty reduction that relies exclusively on redistributing wealth from the rich and the middle classes to the poor. In principle, a country pursuing redistributive policies could reduce poverty even if its total income did not grow. But we would be hard-pressed to find real-world examples. Policies that increase the incomes of the poor, such as investments in primary education, rural infrastructure, health and nutrition, tend to enhance the productive capacity of the whole economy, boosting the incomes of all groups.

What does a high correlation between growth and the incomes of the poor tell us? Practically nothing, for the reasons outlined above. All it shows is that income distribution tends to be stable and fairly unresponsive to policy changes. Moreover, a strong correlation between economic growth and poverty reduction is compatible with *both* of the following arguments: (1) only policies that target growth can reduce poverty; and (2) only policies that reduce poverty can boost overall economic growth. Therefore, the observed correlation between growth and poverty reduction is of little interest as far as policy choices and priorities are concerned.

**The real question is (or ought to be) whether open trade policies are a reliable mechanism for generating self-sustaining growth and poverty reduction....**

A somewhat different question is whether the well-being of the poor should enter as an independent determinant of policy choices, in addition to the usual focus on macroeconomic stability, microeconomic efficiency, and institutional quality. In other words, should economic reform strategies have a poverty focus?

Yes, for at least three reasons. First, in considering social welfare, most people in general, and most democratically elected governments in particular, would give more weight to the well-being of the poor than to that of the rich. An economy's growth rate is not a sufficient statistic for evaluating welfare because it ignores the distribution of the rewards of growth. A policy that increases the income of the poor by one rupee can be worthwhile at the margin even if it costs the rest of society more than a rupee. From this perspective, it may be entirely rational and proper for a government considering two competing growth strategies to choose the one that has greater potential payoff for the poor even if its impact on overall growth is less assured.

Second, even if the welfare of the poor does not receive extra weight, interventions aimed at helping the poor may still be the most effective way to raise average incomes. Poverty is naturally associated with market imperfections and incompleteness. The poor remain poor because they cannot borrow against future earnings to invest in education, skills, new crops and entrepreneurial activities. They are cut off from economic activity because they are deprived of many collective goods (e.g., property rights, public safety, infrastructure) and lack information about market opportunities. It is a standard tenet of economic theory that raising real average incomes requires interventions targeted at closing gaps between private and social costs. There will be a preponderance of such opportunities where there is a preponderance of poverty.

Third, focusing on poverty is also warranted from the perspective of an approach to development that goes beyond an exclusive focus on consumption or income levels to embrace human capabilities. As Amartya Sen (1999) has emphasized, the overarching goal of development is to maximize people's capabilities—that is, their ability to lead the kind of life they value. The poor face the greatest hurdles in this area and are therefore the most deserving of urgent policy attention.

Policy-makers make choices and determine priorities all the time. The lens through which they perceive development profoundly affects their choices. Keeping poverty in sight ensures that their priorities are not distorted. Consider some illustrative tradeoffs.

- **Fiscal policy.** How should a government resolve the trade-off between higher spending on poverty-related projects (rural infrastructure, say) and the need for tight fiscal policies? Should it risk incurring the disapproval of financial markets as the price of better irrigation? How should it allocate its educational budget? Should more be spent on building primary schools in rural areas or on training bank auditors and accountants?
- **Market liberalization.** Should the government maintain price controls on food crops, even if such controls distort resource allocation in the economy? Should it remove capital controls on the balance of payments, even if that means fiscal resources will be tied up in holding additional foreign reserves—resources that could otherwise have been used to finance a social fund?

- ***Institutional reform.*** How should the government design its anti-corruption strategy? Should it target the large-scale corruption that foreign investors complain about or the petty corruption in the police and judicial systems that affects ordinary citizens? Should legal reform focus on trade and foreign investment or domestic problems? Whose property rights should receive priority, peasants or foreign patent holders? Should the government pursue land reform, even if it threatens politically powerful groups?

As these examples illustrate, in practice, even the standard, growth-oriented desiderata of macroeconomic stability, microeconomic efficiency and institutional reform leave considerable room for manoeuvre. Governments can use this room to better or worse effect. A poverty focus helps ensure that the relevant trade-offs are considered explicitly.

Since growth and poverty reduction go largely hand in hand, the real questions are: What are the policies that yield these rewards? How much do we know about policy impacts? The honest answer is that we do not know nearly enough. We have evidence that land reforms, appropriately targeted price reforms and certain types of health and education expenditures benefit the poor, but we are uncertain about many things. It is one thing to say that development strategies should have a poverty focus, another to identify the relevant policies.

But this is not a strike against poverty-oriented programmes, since we are equally uncertain about growth-oriented programmes. The uncomfortable reality is that our knowledge about the kinds of policies that stimulate growth remains limited. We know that large fiscal and macroeconomic imbalances are bad for growth. We know that ‘good’ institutions are important, even though we have very little idea about how countries can acquire them. And, despite a voluminous literature on the subject, we know next to nothing about the kinds of trade policies that are most conducive to growth (see below).

For all of these reasons, it is not productive to make a sharp distinction between policies that promote growth and those that target the poor directly. These policies are likely to vary considerably depending on institutional context, making it difficult to generalize with any degree of precision. Our real focus should be on what works, how, and under what circumstances.

### **Achieving Economic Growth: What Really Matters?**

The enlightened standard view of development policy grew out of dissatisfaction with the limited results yielded by the Washington Consensus policies of the 1980s and 1990s. The disappointing growth performance and increasing economic insecurity in Latin America—the region that went furthest with policies of privatization, liberalization and openness—the failures in the former Soviet Union, and the Asian financial crisis of 1997-98 all contributed to a refashioning, resulting in the ‘augmented Washington Consensus’ (shown in Table 1). This goes beyond liberalization and privatization to emphasize the need to create the institutional underpinnings of market economies. Reforms now include financial regulation and prudential supervision, governance and anti-corruption, legal and administrative reform, labour-market ‘flexibility’ and social safety nets.

**Table 1**

<b>The Original Washington Consensus</b>	<b>The Augmented Washington Consensus</b>
Fiscal discipline	<i>The original list plus:</i>
Reorientation of public expenditures	Legal/political reform
Tax reform	Regulatory institutions
Financial liberalization	Anti-corruption
Unified and competitive exchange rates	Labour market flexibility
Trade liberalization	WTO agreements
Openness to DFI	Financial codes and standards
Privatization	'Prudent' capital-account opening
Deregulation	Non-intermediate exchange rate regimes
Secure property rights	Social safety nets
	Poverty reduction

Operationally, these institutional reforms are heavily influenced by an Anglo-American conception of what constitutes desirable institutions (as in the preference for arms-length finance over 'development banking' and flexible labour markets over institutionalized labour markets). In addition, they are driven largely by the requirements of integration into the world economy: hence the emphasis on the international harmonization of regulatory practices, as in the case of financial codes and standards and of the WTO agreements.

Market economies rely on a wide array of non-market institutions that perform regulatory, stabilizing, and legitimizing functions (see Rodrik 2001a). Cross-national econometric work shows that the quality of a country's public institutions is a critical, and perhaps the most important, determinant of a country's long-term development (Acemoglu et al. 2000). While the recent emphasis on institutions is thus highly welcome, it needs to be borne in mind that the institutional basis for a market economy is not uniquely determined. There is no single mapping between a well-functioning market and the *form* of non-market institutions required to sustain it, as is clear from the wide variety of regulatory, stabilizing and legitimizing institutions in today's advanced industrial societies. The American style of capitalism is very different from the Japanese style of capitalism. Both differ from the European style. And even within Europe, there are large differences between the institutional arrangements in, say, Sweden and Germany. Over the long term, each of these have performed equally well.<sup>2</sup>

The point about institutional diversity has in fact a more fundamental implication. As Roberto Unger (1998) argues, the institutional arrangements in operation today, varied as they are, themselves constitute a subset of the full range of potential institutional possibilities. There is no reason to suppose that modern societies have exhausted

all useful institutional variations that could underpin healthy and vibrant economies. We must avoid thinking that a specific type of institution—mode of corporate governance, social security system or labour market legislation, for example—is the only one compatible with a well-functioning market economy.

Leaving aside the question of long-term choice over institutional forms, the enlightened standard view, insofar as it is presented as a recipe for stimulating economic growth, also suffers from a fatal flaw: it provides no sense of priorities among a long and highly demanding list of institutional prerequisites. This kitchen-sink approach to development strategy flies in the face of practical reality and is at odds with the historical experience of today's advanced industrial economies. What are today regarded as key institutional reforms in areas such as corporate governance, financial supervision, trade law and social safety nets did not take place in Europe or Northern America until quite late in the economic development process (Chang 2000). Indeed, many of the items on the augmented Washington Consensus agenda (Table 1) should be properly viewed as *outcomes* of successful economic development rather than its prerequisites.

The reality of growth transformations is that they are instigated by an initially narrow set of policy and institutional initiatives, which might be called 'investment strategies' (Rodrik 1999). Adequate human resources, public infrastructure, social peace and stability are all key enabling elements of an investment strategy. But often the critical factor is a set of targeted policy interventions that kindle the animal spirits of domestic investors. These investment strategies set off a period of economic growth, which in turn facilitates a cycle of institutional development and further growth. The initiating reforms are rarely replicas of each other, and they bear only partial resemblance to the requirements highlighted by the enlightened standard view. Typically, they entail a mix of orthodoxy with unconventional domestic innovations.

An analysis of three sets of investment strategies will elucidate this central point and highlight the different paths taken to greater prosperity: import-substitution, East-Asian-style outward orientation and two-track reform strategies. The list is not meant to be exhaustive, and in the future successful strategies are likely to differ from all three.

### ***Import-Substituting Industrialization (ISI)***

Import-substituting industrialization is based on the idea that domestic investment and technological capabilities can be spurred by providing home producers with (temporary) protection against imports. Although this approach has fallen into disgrace since the 1980s, it actually did quite well for a substantial period of time in scores of developing nations. Until the first oil shock hit in 1973, no fewer than 42 developing countries grew at rates exceeding 2.5 per cent per capita per annum (see Rodrik 1999: ch.4). At this rate, incomes would double every 28 years or less. Most of these countries followed ISI policies. The list includes 12 countries in South America, six in the Middle East and North Africa, and 15 in Sub-Saharan Africa. In fact, there were no less than six Sub-Saharan African countries among the 20 fastest-growing developing countries in the world prior to 1973: Swaziland, Botswana, Côte d'Ivoire, Lesotho, Gabon and Togo, with Kenya ranking 21st. There can be little doubt that economic growth led to substantial improvements in the living conditions of the vast majority of the house-

holds in these countries. Between 1967 and 1977, life expectancy at birth increased by four years in Brazil (from 58 to 62), by five years in Cote d'Ivoire (from 43 to 48), by five years in Mexico (from 60 to 65), and by five years in Pakistan (from 48 to 53). In Kenya, infant mortality fell from 112 (per 1,000 live births) in 1965 to 72 in 1980.

ISI policies spurred growth by creating protected and therefore profitable home markets for domestic entrepreneurs to invest in. Contrary to received wisdom, ISI-driven growth did not produce technological lags and inefficiency on an economy-wide scale. In fact, the productivity performance of many Latin American and Middle Eastern countries was, in comparative perspective, exemplary. According to estimates produced by Collins and Bosworth (1996), not only was average total factor productivity (TFP) growth during the period preceding the first oil shock quite high in the Middle East and Latin America (at 2.3 and 1.8%, respectively), it was actually significantly higher than in East Asia (1.3%)! Countries such as Brazil, the Dominican Republic and Ecuador in Latin America; Iran, Morocco and Tunisia in the Middle East; and Côte d'Ivoire and Kenya in Africa all experienced more rapid TFP growth than any of the East Asian countries in this early period (with the possible exception of Hong Kong, for which comparable data are not available). Mexico, Bolivia, Panama, Egypt, Algeria, Tanzania and Zaire experienced higher TFP growth than all but Taiwan. Of course, not all countries following ISI policies did well: Argentina is a striking counter-example, with an average TFP growth of only 0.2 per cent from 1960 to 1973.

The dismal reputation of ISI is due partly to the subsequent economic collapse experienced by many of the countries pursuing it in the 1980s, and partly to the extremely influential studies of Little, Scott and Scitovsky (1970) and Bela Balassa (1971). What these two studies did was to document in detail some of the *static* economic inefficiencies generated by high and extremely dispersed effective rates of protection (ERP) in the manufacturing sectors of the countries under study. The discovery of cases of negative value-added at world prices—that is, cases where countries would have been better off by throwing away the inputs than by processing them as they did in highly protected plants—was particularly shocking. However, neither study claimed to show that countries which had followed 'outward oriented' strategies had been systematically immune from the same kind of inefficiencies. In fact, their evidence can be read as suggesting that there was no such clear dividing line.<sup>3</sup> In addition, the evidence on TFP growth reviewed above shows that the idea that ISI produced more dynamic inefficiency than did 'outward orientation' is simply incorrect.

Hence, as an industrialization strategy intended to raise domestic investment and enhance productivity, import substitution apparently worked pretty well in a very broad range of countries until at least the mid-1970s. However, starting in the second half of the 1970s, a disaster befell the vast majority of the economies that had been doing well. Of the 42 countries with growth rates above 2.5 per cent prior to 1973, less than a third (12) managed the same record over the next decade. The Middle East and Latin America, which had led the developing world in TFP growth prior to 1973, not only fell behind, but actually began to experience *negative* TFP growth on average. Only East Asia held its own, while South Asia actually improved its performance (see Collins and Bosworth 1996).

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Was this a result of the ‘exhaustion’ of import-substitution policies? As I have argued elsewhere (Rodrik 1999), the common timing implicates the turbulence experienced in the world economy following 1973—the abandonment of the Bretton Woods system of fixed exchange rates, two major oil shocks, various other commodity boom-and-bust cycles, plus the U.S. Federal Reserve interest-rate shock of the early 1980s. The fact that some of the most ardent followers of ISI policies in South Asia—especially India and Pakistan — managed to either hold on to their growth rates after 1973 (Pakistan) or increase them (India) also suggests that more than just ISI was involved.<sup>4</sup>

The actual story implicates macroeconomic policies rather than the trade regime. The proximate reason for the economic collapse was the inability to adjust macroeconomic policies appropriately in the wake of these external shocks. Macroeconomic maladjustment gave rise to a range of syndromes associated with macroeconomic instability—high or repressed inflation, scarcity of foreign exchange and large black-market premiums, external payments imbalances and debt crises—which greatly magnified the real costs of the shocks. Countries that suffered the most were those with the largest increases in inflation and black-market premiums for foreign currency. The culprits were poor monetary and fiscal policies and inadequate adjustments in exchange-rate policy, sometimes aggravated by shortsighted policies of creditors and the Bretton Woods institutions. The bottom line is that in those countries that experienced a debt crisis, the crisis was the product of monetary and fiscal policies that were incompatible with sustainable external balances: there was too little expenditure reducing and expenditure switching. Trade and industrial policies had very little to do with bringing on the crisis.

Why were some countries quicker to adjust their macroeconomic policies than others? The real determinants of growth performance after the 1970s are rooted in the ability of domestic institutions to manage the distributional conflicts triggered by the external shocks of the period. Social conflicts and their management—whether successful or not—played a key role in transmitting the effects of external shocks on to economic performance. Societies with deep social cleavages and poor institutions of conflict management proved worse at handling shocks (see Rodrik 1999).

### **‘Outward-Oriented’ Industrialization**

The experience of the East Asian tigers is often presented as one of export-led growth, in which opening up to the world economy unleashed powerful forces of industrial diversification and technological catch-up. However, the conventional account overlooks the active role taken by the governments of Taiwan Province of China and the Republic of Korea (and Japan before them) in shaping the allocation of resources. In neither of these countries was there significant import liberalization early in the process of growth. Most of their trade liberalization took place in the 1980s, when high growth was already firmly established.

The key to these and other East Asian countries’ success was a coherent strategy of raising the return to private investment, through a range of policies that included credit subsidies and tax incentives, educational policies, establishment of public enterprises, export inducements, duty-free access to inputs and capital goods and actual govern-

ment coordination of investment plans. In the Republic of Korea, the chief form of investment subsidy was the extension of credit to large business groups at negative real interest rates. Korean banks were nationalized after the military coup of 1961, and consequently the government obtained exclusive control over the allocation of investible funds in the economy. Another important manner in which investment was subsidized in Korea was through the socialization of investment risk in selected sectors. This emerged because the government—most notably President Park—provided an implicit guarantee that the state would bail out entrepreneurs investing in ‘desirable’ activities if circumstances later threatened the profitability of those investments. In Taiwan, investment subsidies took the form of tax incentives.

In both the Republic of Korea and Taiwan, public enterprises played a very important role in enhancing the profitability of private investment by ensuring that key inputs were available locally for private producers downstream. Not only did public enterprises account for a large share of manufacturing output and investment in each country, their importance actually increased during the critical take-off years of the 1960s. Singapore also heavily subsidized investment, but this country differs from the Republic of Korea and Taiwan in that its investment incentives centred heavily on foreign investors.

While trade policies that spurred exports were part of this complex arsenal of incentives, investment and its promotion was the key goal in all countries. To that end, governments in the Republic of Korea and Taiwan freely resorted to unorthodox strategies: they protected the home markets to raise profits, implemented generous export subsidies, encouraged their firms to reverse-engineer foreign patented products, and imposed performance requirements such as export-import balance requirements and domestic content requirements on foreign investors (when foreign companies were allowed in). All of these strategies are now severely restricted under the WTO agreements.

### **The Two-Track Strategy**

A relatively minimal set of reforms in China in the late 1970s set the stage for the phenomenal economic performance that has been the envy of any poor country since. Initial reforms were relatively simple: they loosened the communal farming system and allowed farmers to sell their crops in free markets once they had fulfilled their quota obligations to the state. Subsequent reforms allowed the creation of township and village enterprises and the extension of the ‘market track’ into the urban and industrial sectors. Special economic zones were created to attract foreign investment. What stands out about these reforms is that they are based on dual tracks (state and market), on gradualism and on experimentation.

One can interpret Chinese-style gradualism in two ways. One perspective, represented forcefully in work by Sachs and Woo (2000) underplays the relevance of Chinese particularism by arguing that the successes of the economy are not due to any special aspects of the Chinese transition to a market economy, but instead are largely due to a *convergence* of Chinese institutions with those in non-socialist economies. In this view, the faster the convergence, the better the outcomes: ‘favorable outcomes have

emerged not because of gradualism, but *despite* gradualism' (ibid:3). The policy message that follows is that countries that look to China for lessons should focus not on institutional experimentation but on harmonizing their institutions with those abroad.

The alternative perspective, perhaps best developed in work by Qian and Roland, is that the peculiarities of the Chinese model represent solutions to particular political or informational problems for which no blueprint-style solution exists. Hence Lau, Qian and Roland (1997) interpret the dual-track approach to liberalization as a way of implementing Pareto-efficient reforms: an alteration in the planned economy that improves incentives at the margin, enhances efficiency in resource allocation, and yet leaves none of the plan beneficiaries worse off. Qian, Roland and Xu (1999) interpret Chinese-style decentralization as allowing the development of superior institutions of coordination: when economic activity requires products with matched attributes, local experimentation is a more effective way of processing and using local knowledge. These analysts find much to praise in the Chinese model because they think the system generates the right incentives for developing the tacit knowledge required to build and sustain a market economy, and therefore they are not overly bothered by some of the economic inefficiencies that may be generated along the way.

A less well-known instance of a successful two-track strategy is that of Mauritius, where superior economic performance has been built on a peculiar combination of orthodox and heterodox strategies. An export processing zone (EPZ), operating under free-trade principles, enabled an export boom in garments to European markets and an accompanying investment boom at home. Yet the island's economy has combined the EPZ with a domestic sector that was highly protected until the mid-1980s: the IMF gave the Mauritian economy the highest (i.e., worst) score on its 'policy restrictiveness' index for the early 1990s, reckoning it was one of the world most protected economies even by the late 1990s (see Subramanian 2001). Mauritius is essentially an example of an economy that has followed a two-track strategy not too dissimilar to that followed by China, but which was underpinned by social and political arrangements that encouraged participation, representation and coalition-building.

The circumstances under which the Mauritian EPZ was set up in 1970 are instructive, and highlight the manner in which participatory political systems help design creative strategies for building locally adapted institutions. Given the small size of the home market, it was evident that Mauritius would benefit from an outward-oriented strategy. But as in other developing countries, policy-makers had to contend with the import-substituting industrialists who had been propped up by the restrictive commercial policies of the early 1960s prior to independence, and who were naturally opposed to relaxing the trade regime.

A Washington economist would have advocated across-the-board liberalization, without regard to what that might do the precarious ethnic and political balance of the island. The EPZ scheme provided a neat way around the political difficulties. The creation of the EPZ generated new opportunities of trade and of employment,

without taking protection away from the import-substituting groups and from the male workers who dominated the established industries. The segmentation of labour markets early on between male and female workers—with the latter predominantly employed in the EPZ—was particularly crucial, as it prevented the expansion of the EPZ from driving wages up in the rest of the economy, thereby disadvantaging import-substituting industries. New employment and profit opportunities were created at the margin, while leaving old opportunities undisturbed. This in turn paved the way for the more substantial liberalizations that took place in the mid-1980s and in the 1990s. By the 1990s, the female-male earning ratio was higher in the EPZ than in the rest of the economy (ILO 2001, table 28). Mauritius found its own way to economic development because it was able to devise a strategy that was unorthodox, yet effective.

### ***The Bottom Line***

These examples suggest that while market incentives, macroeconomic stability and sound institutions are critical to economic development, they can be generated in a number of different ways—by making the best use of existing capabilities in light of resource and other constraints. There is no single model of a successful transition to a high-growth path. Each country has to figure out its own investment strategy. Once the appropriate strategy is identified (or stumbled upon), the institutional reforms needed may not be extensive. Most of the institutional development occurs alongside economic development, not as a prerequisite to it.

### **Trade Liberalization, Growth and Poverty Reduction: What Do the Facts Really Show?**

Consider two countries, A and B. Country A engages in state trading, maintains import monopolies, retains quantitative restrictions and high tariffs (in the range of 30-50 per cent) on imports of agricultural and industrial products and is not a member of the WTO. Country B, a WTO member, has slashed import tariffs to a maximum of 15 per cent and removed all quantitative restrictions, earning a rare commendation from the U.S. State Department that ‘there are few significant barriers to U.S. exports’ (US State Department 1999). One of the two economies has experienced GDP growth rates in excess of 8 per cent per annum, has sharply reduced poverty, has expanded trade at double-digit rates, and has attracted large amounts of foreign investment. The other economy has stagnated and suffered deteriorating social indicators, and has made little progress in integrating with the world economy as judged by trade and foreign investment flows.

Country A is Viet Nam, which since the mid-1980s has followed Chinese-style gradualism and a two-track reform programme. Country B is Haiti. Viet Nam has been phenomenally successful, achieving not only high growth and poverty reduction, but also a rapid pace of integration into the world economy despite high barriers to trade. Haiti’s economy has gone nowhere, even though the country undertook a comprehensive trade liberalization in 1994-95.

The contrasting experiences of these two countries highlight two important points. First, a leadership committed to development and standing behind a coherent growth

**Integration with the world economy is an outcome, not a prerequisite, of a successful growth strategy.**

strategy counts for a lot more than trade liberalization, even when the strategy departs sharply from the enlightened standard view on reform. Second, integration with the world economy is an outcome, not a prerequisite, of a successful growth strategy. Protected Viet Nam is integrating with the world economy significantly more rapidly than is open Haiti, because Viet Nam is growing and Haiti is not.

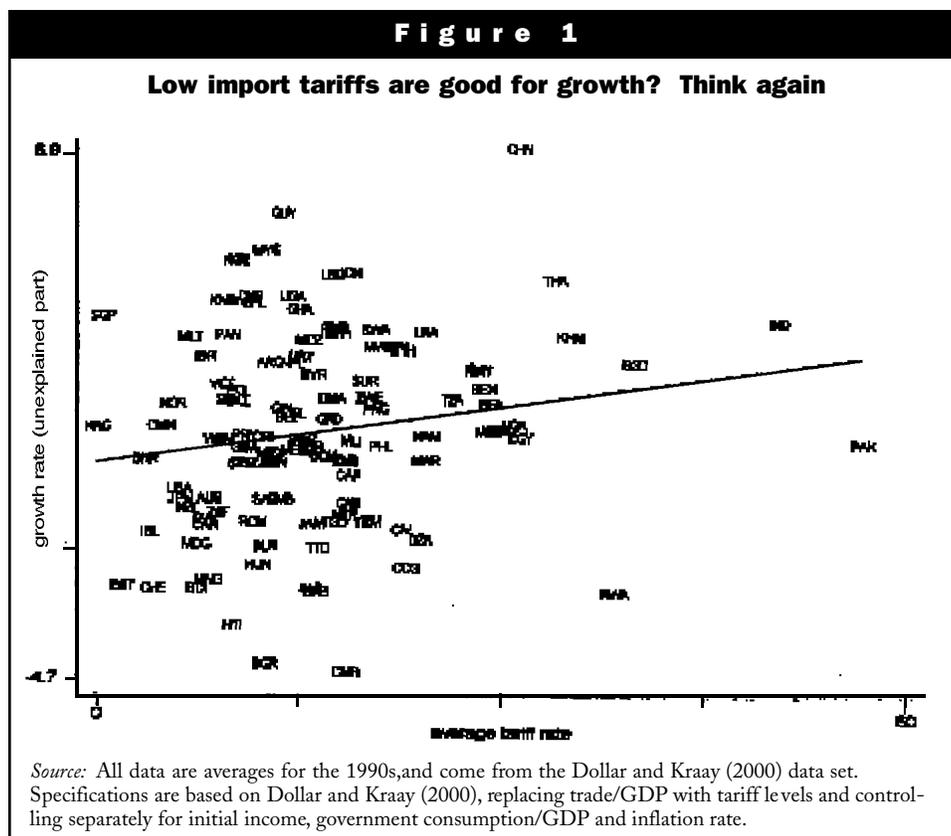
This comparison illustrates a common misdiagnosis. A typical World Bank exercise consists of classifying developing countries into ‘globalizers’ and ‘non-globalizers’ based on their rates of growth of trade volumes. The analyst asks whether globalizers (i.e., those with the highest rates of trade growth) have experienced faster income growth, greater poverty reduction and worsened income distribution (see Dollar and Kraay 2000). The answers tends to be yes, yes, and no. As the Viet Nam and Haiti cases show, however, this is a highly misleading exercise. Trade volumes are the outcome of many different things, including most importantly an economy’s overall performance. They are not something that governments control directly. What governments control are trade *policies*: the level of tariff and non-tariff barriers, membership in the WTO, compliance with its agreements and so on. The relevant question is: Do open trade *policies* reliably produce higher economic growth and greater poverty reduction?

Cross-national comparison of the literature reveals no systematic relationship between a country’s average level of tariff and non-tariff restrictions and its subsequent economic growth rate. If anything, the evidence for the 1990s indicates a *positive* (but statistically insignificant) relationship between tariffs and economic growth (see Figure 1). The only systematic relationship is that countries dismantle trade restrictions as they get richer. That accounts for the fact that today’s rich countries, with few exceptions, embarked on modern economic growth behind protective barriers, but now have low trade barriers.

The absence of a robust positive relationship between open trade policies and economic growth may come as a surprise in view of the ubiquitous claim that trade liberalization promotes higher growth. Indeed, the literature is replete with cross-national studies concluding that growth and economic dynamism are strongly linked to more liberal trade policies. For example, an influential study by Sachs and Warner (1995) found that economies that are open, by their definition, grew 2.4 percentage points faster annually than did those that are not—an enormous difference. Without such studies, organizations such as the World Bank, IMF and the WTO could not have been so vociferous in their promotion of trade-centric development strategies.

Upon closer look, however, these studies turn out to be flawed. The classification of countries as ‘open’ or ‘closed’ in the Sachs-Warner study, for example, is not based on actual trade policies but largely on indicators related to exchange rate policy and location in Sub-Saharan Africa. Their classification of countries in effect conflates macroeconomics, geography and institutions with trade policy. It is so correlated with plausible groupings of alternative explanatory variables—macroeconomic instability, poor institutions, location in Africa—that one cannot draw from the subsequent empirical analysis any strong inferences about the effects of openness on growth (see Rodriguez and Rodrik 2001).

The problem is a general one. In a review of the best-known literature (Dollar 1992; Ben-David 1993; Edwards 1998; Frankel and Romer 1999; Sachs and Warner



1995), Francisco Rodriguez and I found a major gap between the policy conclusions that are typically drawn and what the research has actually shown. A common problem has been the misattribution of macroeconomic phenomena (e.g., overvalued currencies or macroeconomic instability) or geographic location (e.g., in the tropical zone) to trade policies. Once these problems are corrected, any meaningful relationship across countries between the level of trade barriers and economic growth evaporates (see also Helleiner 1994).

In practice, the relationship between trade openness and growth is likely to be a contingent one, dependent on a host of internal and external characteristics. The fact that practically all of today's advanced countries embarked on their growth behind tariff barriers, and reduced protection only subsequently, surely offers a clue of sorts. Moreover, the modern theory of endogenous growth yields an ambiguous answer to the question of whether trade liberalization promotes growth, one that depends on whether the forces of comparative advantage push the economy's resources towards activities that generate long-run growth (research and development, expanding product variety, upgrading product quality, etc.) or divert them from such activities.

No country has developed successfully by turning its back on international trade and long-term capital flows. Very few countries have grown over long periods of time without experiencing an increase in the share of foreign trade in their national product. In practice, the most compelling mechanism that links trade with growth in developing countries is that imported capital goods are likely to be significantly cheaper than those manufactured at home. Policies that restrict imports of capital

equipment, raise the price of capital goods at home and thereby reduce real investment levels have to be viewed as undesirable on the face of it – although this does not rule out the possibility of selective infant industry policies in certain segments of capital-goods industries. Exports, in turn, are important since they permit the purchase of imported capital equipment.

But it is equally true that no country has developed simply by opening itself up to foreign trade and investment. The trick has been to combine the opportunities offered by world markets with a domestic investment and institution-building strategy to stimulate the animal spirits of domestic entrepreneurs. Almost all of the outstanding cases—East Asia, China, India since the early 1980s—involve partial and gradual opening up to imports and foreign investment.

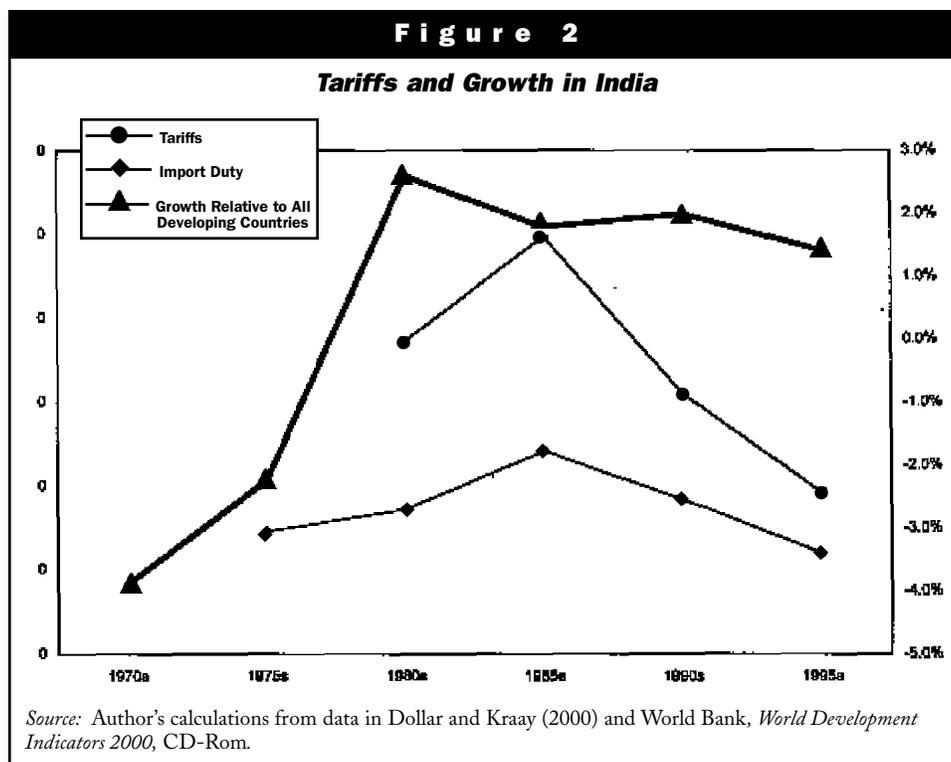
The experiences of China and India are particularly noteworthy, as they are two huge countries that have done extremely well recently, and are often cited as examples of what openness can achieve (see Stern 2000:3). The reality, once again, is more complicated. In both India and China, the main trade reforms took place about a decade *after* the onset of higher growth. Moreover, these countries' trade restrictions remain among the highest in the world. As noted briefly above, the increase in China's growth started in the late 1970s with the introduction of the household responsibility system in agriculture and of two-tier pricing. Trade liberalization did not start in earnest until much later, during the second half of the 1980s and especially during the 1990s, once the trend growth rate had already increased substantially.

The case of India is shown in Figure 2. As the figure makes clear, India's trend growth rate increased substantially in the early 1980s (a fact that stands out particularly clearly when it is compared against other developing countries), while serious trade reform did not start until 1991-93. The tariff averages displayed in the chart show that tariffs were actually higher in the rising growth period of the 1980s than in the low-growth 1970s. To be sure, tariffs hardly constitute the most serious trade restrictions in India, but they nonetheless display the trends in Indian trade policy fairly accurately.

Of course, both India and China did 'participate in international trade,' and by that measure they are both globalizers. But the relevant question for policy-makers is not whether trade per se is good or bad—countries that do well also increase their trade/GDP ratios as a by-product—but what the correct sequence of policies is and how much priority deep trade liberalization should receive early in the reform process. With regard to the latter questions, the experiences of India and China are suggestive of the benefits of a gradual, sequenced approach.

To repeat, the appropriate conclusion is not that trade protection is inherently preferable to trade liberalization; certainly, there is scant evidence from the last 50 years that inward-looking economies experience systematically faster economic growth than open ones. But the benefits of trade openness are now greatly oversold. Deep trade liberalization cannot be relied on to deliver high rates of economic growth and therefore does not deserve the high priority it typically receives in the development strategies pushed by leading multilateral organizations.<sup>5</sup>

As Helleiner (2000: 3) puts it, there are 'few reputable developing country analysts or governments who question the positive potential roles of international trade or



capital inflow in economic growth and overall development. How *could* they question the inevitable need for participation in, indeed a considerable degree of integration with, the global economy?' The real debate is not over whether integration is good or bad, but over matters of policy and priorities: 'It isn't at all obvious *either* (1) that further external liberalization ('openness') is now in every country's interest and in all dimensions *or* (2) that in the overarching sweep of global economic history what the world now *most* requires is a set of global rules that promote or ease the path to greater freedom for global market actors, and are universal in application' (ibid: 4).

### **The Integrationist Agenda and the Crowding Out of Development Priorities**

Priorities are important because in the enlightened standard view, insertion into the world economy is no longer a matter of simply removing trade and investment barriers. Countries have to satisfy a long list of institutional requirements in order to maximize the gains and minimize the risks of participation in the world economy. Global integration remains the key prerequisite for economic development, but there is now a lot more to it than just throwing the borders open. Reaping the gains from openness requires a full complement of institutional reforms.

So trade liberalization entails not only the lowering of tariff and non-tariff barriers, but also compliance with WTO requirements on subsidies, intellectual property, customs procedures, sanitary standards and policies vis-à-vis foreign investors. Moreover, these legal requirements have to be complemented with additional reforms to ensure favourable economic outcomes: tax reform to make up for lost tariff revenues; social safety nets to compensate displaced workers; credibility enhancing

institutional innovations to quell doubts about the permanence of the reforms; labour-market reform to enhance labour mobility across industries; technological assistance to upgrade firms adversely affected by import competition; training programmes to ensure that export-oriented firms and investors have access to skilled workers; and so on. Reading World Bank reports on trade policy, one can be excused for thinking that the list of complementary reforms is virtually endless.

Notwithstanding the overly Anglo-American conception of institutional possibilities reflected in the Washington agenda for integrationist reform, many of the proposed institutional reforms are perfectly sensible ones, and in a world without financial, administrative or political constraints, there would be little argument about the need to adopt them. But in the real world, fiscal resources, administrative capabilities and political capital are all scarce, and choices need to be made about how to deploy them. In such a world, viewing institutional priorities from the vantage point of insertion in the global economy has real opportunity costs.

Some trade-offs are illustrative. It has been estimated that it costs a typical developing country \$150 million to implement requirements under just three of the WTO agreements: customs valuation, sanitary and phytosanitary measures (SPS) and intellectual property rights (TRIPS). As the World Bank's Michael Finger points out, this is a sum equal to a year's development budget for many of the least-developed countries (Finger and Schuler 1999).

In the area of legal reform, should the government focus its energies on 'importing' legal codes and standards, or on improving existing domestic legal institutions? In Turkey, a weak coalition government spent several months gathering political support for a bill that would provide foreign investors the protection of international arbitration. Wouldn't it have been a better strategy for the long run to reform the existing legal regime for the benefit of foreign *and* domestic investors alike?

In public health, should the government pursue tough policies on compulsory licensing and/or parallel importation of basic medicines, even if that means running afoul of existing WTO rules? The United States has charged that Brazil's highly successful treatment programme for HIV/AIDS violates WTO rules because it allows the government to seek compulsory licensing when a foreign patent holder does not 'work' the patent locally.

In industrial strategy, should the government simply open up and let the chips drop wherever they might, or should it emulate East Asian experience of industrial policies through export subsidies, directed credit and selective protection?

How should the government focus its anti-corruption strategy? Should it target the 'grand' corruption that foreign investors complain about, or the petty corruption that affects the poor the most? Perhaps, as proponents of permanent normal trade relations with China argued in the recent U.S. Congressional debate, a government that is forced to protect the rights of foreign investors becomes more inclined to protect the human rights of its own citizens too. But isn't this at best a trickle-down strategy of institutional reform? Shouldn't institutional reform be targeted on the desired ends directly—whether those ends are the rule of law, improved observance of human rights or reduced corruption?

The rules for admission into the world economy not only reflect little awareness of development priorities, they are often completely unrelated to sensible economic principles. WTO rules on anti-dumping, subsidies and countervailing measures, agriculture, textiles, trade related investment measures (TRIMS) and trade related intellectual property rights (TRIPS) are utterly devoid of any economic rationale beyond the mercantilist interests of a narrow set of powerful groups in the advanced industrial countries. The developmental pay-off of most of these requirements is hard to see.

Bilateral and regional trade agreements are often far worse, as they impose even tighter prerequisites on developing countries in return for crumbs of enhanced 'market access' in the larger partners. The Africa Growth and Opportunity Act passed by the U.S. Congress in 2000, for example, contains a long list of eligibility criteria, including the requirement that African governments minimize interference in the economy. It provides free access to U.S. markets only under strict rules of origin, thereby ensuring that few economic linkages are generated in the African countries themselves. The U.S.-Jordan Free Trade Agreement imposes more restrictive intellectual property rules on Jordan than exist under the WTO.

In each of these areas, a strategy focused on integration crowds out more development-friendly alternatives. Many of the institutional reforms needed for insertion in the world economy can be independently desirable, or produce broader spillovers. But these priorities do not necessarily coincide with the priorities of a broader development agenda. A strategy that focuses on getting the state out of the way of the market overlooks the important functions that the state must play during the process of economic transformation. What belongs on the agenda of institutional reform is building up state capacity—not diminishing it (Evans 2000).

World markets are a source of technology and capital; it would be silly for the developing world not to exploit these opportunities. But, as I have argued above, successful development strategies have always required a judicious blend of imported practices with domestic institutional innovations. Policy-makers need to forge a *domestic* growth strategy, relying on domestic investors and domestic institutions. The most costly downside of the integrationist agenda is that it is crowding out serious thinking and efforts along such lines.

### **An International Trade Regime That Puts Development First: General Principles**

Access to the markets of the industrial countries matters for development. But so does the autonomy to experiment with institutional innovations that diverge from orthodoxy. The exchange of reduced policy autonomy in the South for improved market access in the North is a bad bargain where development is concerned.

Consider the old GATT system, under which the international trade regime did not reach much beyond tariff and non-tariff barriers to trade. The developing countries were effectively exempt from prevailing disciplines. The 'most favoured nation' principle ensured that they benefited from the tariff cuts negotiated among the industrial countries, while they themselves 'gave up' little in return. The resulting pattern of liberalization may have been asymmetric (with many products of interest to developing

**In each of these areas, a strategy focused on integration crowds out more development-friendly alternatives.**

countries either excluded or receiving less beneficial treatment), but the net effect for the developing world was still highly salutary.

It is in such an environment that the most successful ‘globalizers’ of an earlier era—the East Asian tigers—managed to prosper. These countries were free to do their own thing, and did so, combining trade reliance with unorthodox policies—export subsidies, domestic-content requirements, import-export linkages, patent and copyright infringements, restrictions on capital flows (including direct foreign investment), directed credit and so on—that are largely precluded by today’s rules.<sup>6</sup> In fact, such policies were part of the arsenal of today’s advanced industrial countries until quite recently (see Scherer and Watal 2001). The environment for today’s globalizers is significantly more restrictive (see Amsden 2000).

For the world’s poorest economies, the so-called least developed countries (LLDCs), something along the old GATT lines is still achievable, and would constitute a more development-friendly regime than the one that exists currently. LLDCs are economies that are individually and collectively small enough that ‘adjustment’ issues in the advanced countries are not a serious obstacle to the provision of one-sided free-market access in the North to the vast majority of products of interest to them. Instead of encumbering these countries with all kinds of institutional requirements that come attached to a ‘single undertaking,’ it would be far better to leave them the room to follow their own institutional priorities, while providing them with access into northern markets that is both duty free and free of quantitative restrictions. In practice, this can be done either by extending existing ‘phase-in’ periods until certain income thresholds are reached, or incorporating a general LLDC exception.

In the case of middle-income and other developing nations, it is unrealistic to expect that advanced industrial countries would be willing to accept a similar arrangement. The amount of political opposition that imports from developing countries generate in the advanced industrial countries is already disproportionate to the volume of trade in question. Some of these objectives have a legitimate core, and it is important that developing nations understand and accept this (see Mayda and Rodrik 2001). Under a sensible set of global trade rules, industrialized countries would have as much right to protect their own social arrangements—in areas such as labour and environmental standards, welfare-state arrangements, rural communities, or industrial organization—as developing nations have to adopt divergent institutional practices. Countries such as India, Brazil, or China, whose exports can have a sizable impact on, say, labour-market institutions and employment relations within the advanced countries, cannot ask importing countries to overlook these effects while demanding at the same time that the constraints on their own developmental agenda be lifted. Middle-income developing countries have to accept a more balanced set of rights and obligations

Is it possible to preserve developing countries’ autonomy while also respecting the legitimate objectives of advanced industrial countries to maintain high labour, social and environmental standards at home? Would such a regime of world trade avoid collapsing into protectionism, bilateralism or regional trade blocs? Would it in fact be development-friendly? The answer to all these questions is yes, provided we accept five simple principles.

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*Trade is a means to an end, not an end in itself.* Step number one is to move away from attaching normative significance to trade itself. The scope of market access generated by the international trade regime and the volume of trade thereby stimulated are poor measures of how well the system functions. As the WTO's preamble emphasizes, trade is useful only insofar as it serves broader developmental and social goals. Developing countries should not be obsessed with market access abroad, at the cost of overlooking more fundamental developmental challenges at home. Industrial countries should balance the interests of their exporters and multinational companies with those of their workers and consumers.

Advocates of globalization lecture the rest of the world incessantly about the adjustments countries have to undertake in their policies and institutions in order to expand their international trade and become more attractive to foreign investors. This is another instance of confusing means for ends. Trade serves at best as an instrument for achieving the goals that societies seek: prosperity, stability, freedom and quality of life. Nothing enrages WTO bashers more than the suspicion that, when push comes to shove, the WTO allows trade to trump the environment or human rights. And developing countries are right to resist a system that evaluates their needs from the perspective of expanding world trade instead of poverty reduction.

Reversing our priorities would have a simple but powerful implication. Instead of asking what kind of multilateral trading system maximizes foreign trade and investment opportunities, we would ask what kind of multilateral system best enables nations around the world to pursue their own values and developmental objectives.

*Trade rules have to allow for diversity in national institutions and standards.* As I have emphasized above, there is no single recipe for economic advancement. This does not mean that anything and everything works: market-based incentives, clear property-control rights, competition and macroeconomic stability are essential everywhere. But even these universal requirements can be and have been embodied in diverse institutional forms. Investment strategies, needed to jump-start economies, can also take different forms.

Moreover, citizens of different countries have varying preferences over the role of government regulations or provision of social welfare, however imperfectly these preferences are articulated or determined. They differ over the nature and extent of regulations to govern new technologies (such things as genetically modified organisms) or protect the environment, of policies to extend social safety nets and, more broadly, about the entire relationship between efficiency and equity. Rich and poor nations have very different needs in the areas of labour standards or patent protection. Poor countries need the space to follow developmental policies that richer countries no longer require. When countries use the trade system to impose their institutional preferences on others, the result is erosion of the system's legitimacy and efficacy. Trade rules should seek peaceful co-existence among national practices, not harmonization.

**Trade rules should seek peaceful co-existence among national practices, not harmonization.**

***Non-democratic countries cannot count on the same trade privileges as democratic ones.***

National standards that deviate from those in trade partners and thereby provide 'trade advantages' are legitimate only to the extent that they are grounded in free choices made by citizens. Think of labour and environmental standards, for example. Poor countries argue that they cannot afford to have the same stringent standards in these areas as the advanced countries. Indeed, tough emission standards or regulations against the use of child labour can easily backfire if they lead to fewer jobs and greater poverty. Democratic countries such as India and Brazil can legitimately argue that their practices are consistent with the wishes of their own citizens, and that therefore it is inappropriate for labour groups or NGOs in advanced countries to tell them what standard they should have. Of course, democracy never works perfectly (in either developing countries or in advanced countries), and one would not want to argue that there are no human rights abuses in the countries just mentioned. The point is simply that the presence of civil liberties and political freedoms provides a presumptive cover against the charge that labour, environmental and other standards in the developing nations are inappropriately low.

But in non-democratic countries, such as China, the assertion that labour rights and the environment are trampled for the benefit of commercial advantage cannot be as easily dismissed. Consequently, exports of non-democratic countries deserve greater scrutiny when they entail costly dislocations or adverse distributional consequences in importing countries. In the absence of the presumptive cover provided by democratic rights, such countries need to make a 'developmental' case for policies that generate adjustment difficulties in the importing countries. For example, minimum wages that are significantly lower than in rich countries or health and other benefits that are less generous can be justified by pointing to lower labour productivity and living standards in poor nations. Lax child labour regulations can sometimes be justified by the argument that under conditions of widespread poverty it is not feasible or desirable to withdraw young workers from the labour force. In other cases, the 'affordability' argument carries less weight: non-discrimination, freedom of association, collective bargaining, prohibition of forced labour do not 'cost' anything; compliance with these 'core labour rights' does not harm, and indeed possibly benefits, economic development. The latter are examples that do not pass the 'development test.'

***Countries have the right to protect their own institutions and development priorities.***

Opponents of today's trade regime argue that trade sets off a 'race to the bottom,' with nations converging towards the lowest levels of environmental, labour and consumer protections. Advocates counter that there is little evidence that trade leads to the erosion of national standards. Developing nations complain that current trade laws are too intrusive, and leave little room for development-friendly policies. Advocates of the WTO reply that these rules provide useful discipline to rein in harmful policies that would otherwise end up wasting resources and hampering development.

One way to cut through this impasse is to accept that countries can uphold national standards and policies in these areas, by withholding market access or suspending WTO obligations if necessary, when trade demonstrably undermines domestic practices that

enjoy broad popular support. For example, poor nations might be allowed to subsidize industrial activities (and indirectly, their exports) when this is part of a broadly supported development strategy aimed at stimulating technological capabilities. Advanced countries might seek temporary protection against imports originating from countries with weak enforcement of labour rights when such imports serve to worsen working conditions at home. The WTO already has a ‘safeguard’ system in place to protect firms from import surges. An extension of this principle to protect developmental priorities or environmental, labour and consumer-safety standards at home—with appropriate procedural restraints against abuse—might make the world trading system more development-friendly, more resilient and less resistant to ad-hoc protectionism.

Currently, the Agreement on Safeguards allows (temporary) increases in trade restrictions under a very narrow set of conditions (see Rodrik 1997). It requires a determination that *increased* imports ‘cause or threaten to cause serious injury to the domestic industry,’ that causality be firmly established and that if there are multiple causes, injury not be attributed to imports. Safeguards cannot be applied to developing-country exporters unless their share of imports of the product concerned is above a threshold. A country applying safeguard measures has to compensate the affected exporters by providing ‘equivalent concessions,’ lacking which the exporter is free to retaliate.

A broader interpretation of safeguards would acknowledge that countries may legitimately seek to restrict trade or suspend existing WTO obligations—to exercise what I call ‘opt-outs’—for reasons going beyond competitive threats to their industries. Among such reasons are, as I have discussed, developmental priorities as well as distributional concerns or conflicts with domestic norms or social arrangements in the industrial countries. We could imagine recasting the current agreement into an Agreement on Developmental and Social Safeguards, which would permit the application of opt-outs under a broader range of circumstances. This would require recasting the ‘serious injury’ test and replacing it with the need to demonstrate broad domestic support, *among all concerned parties*, for the proposed measure.

To see how that might work in practice, consider what the current agreement says:

A Member may apply a safeguard measure only following an investigation by the competent authorities of that Member pursuant to procedures previously established and made public in consonance with Article X of the GATT 1994. This investigation shall include reasonable public notice to all interested parties and public hearings or other appropriate means in which *importers, exporters and other interested parties could present evidence and their views*, including the opportunity to respond to the presentations of other parties and to submit their views, inter alia, as to *whether or not the application of a safeguard measure would be in the public interest*. The competent authorities shall publish a report setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law. (WTO 1995:9; emphasis added)

The main shortcoming of this clause is that while it allows all relevant groups,

and exporters and importers in particular, to make their views known, it does not actually compel them to do so. Consequently, it results in a strong bias in the domestic investigative process towards the interests of import-competing groups, who are the petitioners for import relief and its obvious beneficiaries. Indeed, this is a key problem with hearings in anti-dumping proceedings, where testimony from other groups besides the import-competing industry is typically not allowed.

The most significant and reliable guarantee against the abuse of opt-outs is informed deliberation at the national level. A critical reform, then, would be to require the investigative process in each country to: (1) gather testimony and views from all relevant parties, including consumer and public-interest groups, importers and exporters, civil society organizations, and (2) determine whether there exists *sufficiently broad support* among these groups for the exercise of the opt-out or safeguard in question. The requirements that groups whose incomes might be adversely affected by the opt-out—importers and exporters—be compelled to testify, and that the investigative body trade off the competing interests in a transparent manner would help ensure that protectionist measures that benefit a small segment of industry at a large cost to society would not have much chance of success. When the opt-out in question is part of a broader development strategy that has already been adopted after broad debate and participation, an additional investigative process need not be launched. This last point deserves to be highlighted in view of the emphasis placed on ‘local ownership’ and ‘participatory mechanisms’ in strategies of poverty reduction and growth promoted by the international financial institutions.

The main advantage of this procedure is that it would force a public debate on the legitimacy of trade rules and when to suspend them, ensuring that all sides would be heard. This is something that rarely happens even in the industrial countries, let alone in developing nations. This procedure could be complemented with a strengthened monitoring and surveillance role for the WTO, to ensure that domestic opt-out procedures are in compliance with the expanded safeguard clause. An automatic sunset clause could ensure that trade restrictions and opt-outs do not become entrenched long after their perceived need has disappeared.

Allowing opt-outs in this manner would not be without its risks. The possibility that the new procedures would be abused for protectionist ends and open the door to unilateral action on a broad front, despite the high threshold envisaged here, has to be taken into account. But as I have already argued, the current arrangements also have risks. The ‘more of the same’ approach embodied in the industrialized countries’ efforts to launch a comprehensive new round of trade negotiations is unlikely to produce benefits for developing nations. Absent creative thinking and novel institutional designs, the narrowing of the room for institutional divergence harms development prospects. It may also lead to the emergence of a new set of ‘grey area’ measures entirely outside multilateral discipline. These are consequences that are far worse than the expanded safeguard regime I have just described.

*But countries do not have the right to impose their institutional preferences on others.* The exercise of opt-outs to uphold a country’s own priorities has to be sharply dis-

**An automatic sunset clause could ensure that trade restrictions and opt-outs do not become entrenched long after their perceived need has disappeared.**

tinguished from using them to impose these priorities on other countries. Trade rules should not force Americans to consume shrimp that are caught in ways that most Americans find unacceptable; but neither should they allow the United States to use trade sanctions to alter the way that foreign nations go about their fishing business. Citizens of rich countries who are genuinely concerned about the state of the environment or of workers in the developing world can be more effective through channels other than trade—via diplomacy or foreign aid, for example. Trade sanctions to promote a country's own preferences are rarely effective, and have no moral legitimacy (except for when they are used against repressive political regimes).

This and the previous principle help us draw a useful distinction between two styles of 'unilateralism'—one that is aimed at protecting differences, and the other aimed at reducing them. When the European Union drags its feet on agricultural trade liberalization, it is out of a desire to 'protect' a set of domestic social arrangements that Europeans, through their democratic procedures, have decided are worth maintaining. When, on the other hand, the United States threatens trade sanctions against Japan because its retailing practices are perceived to harm American exporters or against South Africa because its patent laws are perceived as too lax, it does so out of a desire to bring these countries' practices into line with its own. A well-designed world trade regime would leave room for the former, but prohibit the latter.

**Other development-friendly measures.** In addition to providing unrestricted access to least developed countries' exports and enabling developing countries to exercise greater autonomy in the use of subsidies, 'trade-related' investment, patent regulations and other measures, a development-friendly trade regime would do the following (see UNCTAD 2000; Raghavan 1996):

- greatly restrict the use of anti-dumping (AD) measures in advanced industrial countries when exports originate from developing countries. A small, but important step would be to require that the relevant investigating bodies take fully into account the consumer costs of anti-dumping action.
- allow greater mobility of workers across international boundaries, by liberalizing for example the movement of natural persons connected to trade in labour-intensive services (such as construction).
- require that all existing and future WTO agreements be fully costed out (in terms of implementation and other costs). It would condition the phasing in of these agreements in the developing countries on the provision of commensurate financial assistance.
- require additional compensation when a dispute settlement panel rules in favour of a developing country complainant, or (when compensation is not forthcoming) require that other countries join in the retaliation.
- provide expanded legal and fact-finding assistance to developing country members of the WTO in prospective dispute settlement cases.

### **Conclusions: From a Market-Exchange Perspective to a Development Perspective**

Economists think of the WTO as an institution designed to expand free trade and thereby enhance consumer welfare, in the South no less than in the North. In reality, it is an institution that enables countries to bargain about market access. 'Free trade' is not the typical outcome of this process; nor is consumer welfare (much less development) what the negotiators have chiefly in mind. Traditionally, the agenda of multilateral trade negotiations has been shaped in response to a tug-of-war between exporters and multinational corporations in the advanced industrial countries (which have had the upper hand), on the one hand, and import-competing interests (typically, but not solely, labour) on the other. The chief textbook beneficiaries of free trade—consumers—do not sit at the table. The WTO can best be understood in this context, as the product of intense lobbying by specific exporter groups in the United States or Europe or of specific compromises between such groups and other domestic groups. The differential treatment of manufactures and agriculture, or of clothing and other goods within manufacturing, the anti-dumping regime, and the intellectual property rights (IPR) regime, to pick some of the major anomalies, are all results of this political process. Understanding this is essential, as it underscores the fact that there is very little in the structure of multilateral trade negotiations to ensure that their outcomes are consistent with development goals, let alone that they be designed to further development.

Hence there are at least three sources of slippage between what development requires and what the WTO does. First, even if free trade were optimal for development in its broad sense, the WTO does not fundamentally pursue free trade. Second, even if it did, there is no guarantee that free trade is the best trade policy for countries at low levels of development. Third, compliance with WTO rules, even when these rules are not harmful in themselves, crowds out a more fully developmental agenda—at both the international and national level.

My main argument has been that the world trading regime has to shift from a 'market access' perspective to a 'development' perspective (see Helleiner 2000:19). Essentially, the shift means that we should stop evaluating the trade regime from the perspective of whether it maximizes the flow of trade in goods and services, and ask instead, 'Do the trading arrangements—current and proposed—maximize the possibilities of development at the national level?' I have discussed why these two perspectives are not the same, even though they sometimes overlap, and have outlined some of the operational implications of such a shift. One is that developing nations have to articulate their needs not in terms of market access, but in terms of the policy autonomy that will allow them to exercise institutional innovations that depart from prevailing orthodoxies. A second is that the WTO should be conceived of not as an institution devoted to harmonization and the reduction of national institutional differences, but as one that manages the interface between different national systems.

This shift to a development perspective would have several important advantages. The first and more obvious is that it would provide for a more development-friendly international economic environment. Countries would be able to use trade as a means for development, rather than being forced to view trade as an end in itself

(and being forced to sacrifice development goals in the bargain). It would 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.

Second, viewing the WTO as an institution that manages institutional diversity (rather than imposing uniformity) provides developing countries a way out of a conundrum inherent in their current negotiating stance. The problem arises from the inconsistency between their demands for space 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 be unable to make a sound and principled defense of their legitimate need for space. And the only way they can gain enhanced market access is by restricting their own policy autonomy in exchange. Once the objective of the trading regime is seen as letting different national economic systems prosper side by side, the debate can become one about each nation’s institutional priorities and how they may be rendered compatible in a development-friendly way.

The third advantage of this shift in perspective is that it provides a way out of the impasse that the trading system finds itself post-Seattle. At present, two groups feel particularly excluded from the decision-making machinery of the global trade regime: developing country governments and northern NGOs. The former complain about the asymmetry in trade rules, while the latter charge that the system pays inadequate attention to values such as transparency, accountability, human rights and environmental sustainability. The demands of these two disenfranchised groups are often perceived to be conflicting—over questions such as labour and environmental standards or the transparency of the dispute settlement procedures—allowing the advanced industrial countries and the WTO leadership to seize the ‘middle’ ground. It is the demands of these two groups, and the apparent tension between them, that has paralyzed the process of multilateral trade negotiations in recent years.

But once the trade regime—and the governance challenges it poses—is seen from a development perspective, it becomes clear that developing country governments and many of the northern NGOs share the same goals: policy autonomy to pursue independent values and priorities, poverty reduction, and human development in an environmentally sustainable manner. The tensions over issues such as labour standards become manageable if the debate is couched in terms of development processes—broadly defined—instead of the requirements of market access. On all counts, then, the shift in perspective provides a better foundation for the multilateral trading regime.

**The WTO should be conceived of not as an institution devoted to harmonization and the reduction of national institutional differences, but as one that manages the interface between different national systems.**

## Notes

1. See, for example, Mike Moore (2000) or his speech at the London Ministerial roundtable, 19 March 2001 ([www.wto.org/english/news](http://www.wto.org/english/news)).
2. The supposition that one set of institutional arrangements must dominate in terms of overall performance has produced the fads of the decade: Europe, with its low unemployment, high growth and thriving culture, was the continent to emulate throughout much of the 1970s; during the trade-conscious 1980s, Japan became the exemplar of choice; and the 1990s have been the decade of U.S.-style freewheeling capitalism.
3. For example, although Taiwan and Mexico are commonly regarded as following diametrically opposed development paths, figures provided by Little et al. (1970: 174-90) show that long after introducing trade reforms, Taiwan had a higher average ERP in manufacturing and greater variation in ERPs than did Mexico.
4. Although India did gradually liberalize its trade regime after 1991, its relative performance began to improve a full decade before these reforms went into effect (in the early 1980s).
5. The same is true of the promotion and subsidization of inward flows of direct foreign investment (see Hanson 2001).
6. A recent illustration is the dispute between Brazil and Canada over Brazil's subsidization of its aircraft manufacturer, Embraer. Brazil lost this case in the WTO, and will either remove the subsidies or have to put up with retaliation from Canada. The Republic of Korea, Taiwan, province of China and Mauritius subsidized their export industries for years without incurring similar sanctions.

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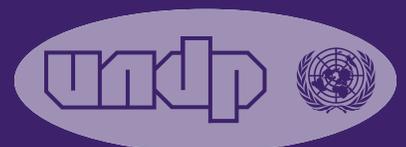
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Trade and Sustainable Human Development Project  
Bureau for Development Policy  
United Nations Development Programme  
1 United Nations Plaza  
New York, NY 10017  
[www.undp.org/bdp](http://www.undp.org/bdp)



The Global  
Governance  
of Trade  
As If  
Development  
Really Mattered

Dani Rodrik

