This volume emerges from the first annual International Forum for Development (IFD), held in New York City on October 17-19, 2004. Amidst growing dissatisfaction with development strategies that have failed to produce adequate rates of growth or to distribute resources equitably, the IFD brought together a diverse group of intellectuals to exchange ideas, to consider the contours of alternative policies and to work toward articulating a more equitable development project. Academics, activists, NGO leaders, policymakers and UN officials were among those who took part in the discussions, which were framed by a series of concept papers and panel presentations. This volume brings together a selection of those interventions, revised in an effort to convey to a broader audience the central points raised during two days of productive interaction. While the first International Forum for Development was a modest effort, it was a vital step in the creation of an alternative vision for development where, as co-chairs Ha-Joon Chang and Deepak Nayyar put it, “the focus is on people rather than economies, and on ends rather than means.”

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Preface: 
The International Forum for Development 

Eric Hershberg & Christy Thornton, Social Science Research Council

This volume emerges from the first annual International Forum for Development (IFD), held in New York City on October 17-19, 2004. Supported by the Ford Foundation and organized by the Social Science Research Council, the forum was intended to enrich debates about development policy at a moment when orthodox policies appear increasingly discredited. Amidst growing dissatisfaction with development strategies that have failed to produce adequate rates of growth or to distribute resources equitably, the IFD brought together a diverse group of intellectuals to exchange ideas, to consider the contours of alternative policies and to work toward articulating a more equitable development project for the coming decade. Academics, activists, NGO leaders, policymakers and UN officials were among those who took part in the discussions, which were framed by a series of concept papers and panel presentations. This volume brings together a selection of those interventions, revised in an effort to convey to a broader audience the central points raised during two days of productive interaction.

This volume is organized into three parts. After a brief introduction by steering committee co-chairs Deepak Nayyar, vice-chancellor of the University of Delhi, and Ha-Joon Chang, professor of development economics at Cambridge University, Part One reflects
on the challenges of development and globalization. José Antonio Ocampo, UN Under-Secretary General for Economic and Social Affairs and a member of the IFD Special Advisory Council, opens this section with a paper that argues that globalization exacerbates existing imbalances in the world economic order and creates new asymmetries as well. Frances Stewart of Oxford University and Gustav Ranis of Yale University then contribute a piece on the central role of human development in the broader development process, arguing that, contrary to much conventional wisdom, economic growth actually depends upon human development. The section concludes with an intervention from Mary Robinson, the former UN High Commissioner for Human Rights, which argues that a human rights approach to development is a useful tool for shifting the focus to those most excluded by current development processes.

Part Two turns to the core theme of the 2004 Forum: growth and employment. First, Professor Amit Bhaduri of the University of Pavia, Italy, argues that the governments of developing countries must actively pursue “high-employment” policies, and that a vital aspect of the road to high employment levels is domestic-led growth. Following this, Robert Rowthorn, professor of economics at Cambridge University, makes the case that northern economies, facing losses from offshoring of manufacturing and services, must create an active policy of redeployment and compensation to deal with workers displaced by international competition.

Part Three examines the effects of northern trade policies on the developing world. This analysis begins with a study by S.P. Shukla, the former Indian ambassador to GATT, in which he argues that the powerful countries in the world trading system are able to manipulate multilateral agreements to their own ends. Mark Weisbrot and Dean Baker, co-directors of the Center for Economic and Policy Research in Washington, DC, then follow with an analysis of the impact of trade liberalization on the developing countries, arguing that gains from trade have been grossly exaggerated and the costs associated with liberalization merit much attention, particularly in policy circles. Part
Three concludes with a brief piece by Raymond Offenheiser, president of Oxfam America, on the challenges to and benefits of implementing a rights-based approach to issues of international trade.

Management of the IFD, now renamed the Globalization and Development Forum and with revamped steering and advisory committees, will continue during the coming years under the auspices of the Carnegie Council on Ethics and International Affairs, which is committed to promoting policies that will enhance social welfare in developed and developing countries alike. In the meantime, we hope that this volume will be a useful tool for scholars, activists and policymakers seeking alternatives to the current orthodoxy of development theory and practice. While the International Forum for Development was a modest effort, it was a vital step in the creation of an alternative vision for development where, as Nayyar and Chang put it, “the focus is on people rather than economies, and on ends rather than means.”

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The Development Imperative:
Toward a People-Centered Approach
I. INTRODUCTION
Development must bring about an improvement in the living conditions of people. It should, therefore, ensure the provision of basic human needs for all: not just food and clothing but also shelter, health care and education. This simple but powerful proposition is often forgotten in the pursuit of material wealth and the conventional concerns of economics. The problem is compounded by the dominant ideology of our times, which states that markets and globalization promise economic prosperity for those who join the system and economic deprivation for those who do not. The reality that has unfolded so far, however, belies the expectations of the ideologues.

The development experience of the world economy from the early 1970s to the late 1990s, which could be termed the age of globalization, provides cause for concern, particularly when it is compared with the period from the late 1940s to the early 1970s, which has been described as the golden age of capitalism.

The reforms of the 1980s and the 1990s, inspired by the current-
ly dominant neo-liberal ideology, were introduced with great promises. They were supposed to accelerate growth and raise efficiency by expanding (through privatization) and freeing the private sector from government intervention. They were supposed to reduce inequality by getting rid of government regulations that create “artificial rents,” or above-market rates of return, that increase inequality. And with higher growth and better income distribution, poverty was naturally expected to fall.

Unfortunately, these expectations have not been met. Growth did not accelerate. It was much slower and more volatile. For example, the developing countries grew at around 3 percent per annum in per capita terms between 1960 and 1980, the “bad old days” of state intervention and import substitution, but their growth rate fell to half that rate between 1980 and 2000, following the reforms. With increasing frequencies in financial crises, growth has been more fitful than before. This process of lower-quality growth was associated with higher levels of unemployment, as well as greater insecurity of employment, almost everywhere. Moreover, a substantial proportion of the workforce saw no significant increase in real wages.

Available evidence suggests a divergence rather than convergence in levels of income between countries and between people. Economic inequalities increased in the last quarter of the twentieth century as the income gap between rich and poor countries, between the rich and the poor in the world’s population, as well as between rich and poor people within countries, has widened.

Clearly, markets and globalization do not ensure prosperity for everyone; in fact, they exclude a significant proportion of countries and people. There is inclusion and growing affluence for a few. There is exclusion and persistent poverty for the many. This emerging reality is morally unacceptable and politically unsustainable.

II. DEPARTURES

The conception of the idea to create an International Forum for Development began with this concern about the dominant ideology
of our times. There are three fundamental points of departure from the prevalent orthodoxy which deserve emphasis.

First, we start from the premise that the well-being of humankind is the essence of development. This is often forgotten in the dominant discourse, where aggregate growth figures or the pro-corporate concept of “economic freedom” get more attention than the well-being of people. Our focus, therefore, must be on people, ordinary people.

Second, it is essential to make a clear distinction between means and ends. Economic growth and economic efficiency are means. Economic development and social progress are ends. Similarly, trade is a means, while development is an end. All these are often forgotten in much of the current debate.

Third, it must be recognized that economic growth is necessary but not sufficient to bring about the eradication of poverty. It cannot suffice to say that the outcomes of economic policies, which ensure growth with efficiency, should be moderated by social policies, say in the form of safety nets. The dichotomy between economic and social development is inadequate just as the dichotomy between economic and social policies is inappropriate. Hence, as in industrial societies, there is a clear need for an integration, rather than a separation, of economic and social policies. At the same time, it is important to create institutional mechanisms that mediate between economic growth and social development. We believe that the time has come to explore alternatives in development, where the focus is on people rather than economies, and on ends rather than means.

III. OBJECTIVES
The essential purpose of the International Forum for Development is to create and to institutionalize a meeting space for concerned scholars and concerned citizens to come together to construct an alternative worldview with a focus on people.

For clarity, it is necessary to contrast our conception with the existing meeting spaces. The World Economic Forum in Davos is organized by corporate leaders to network with each other and to meet with a select group of political leaders, policymakers and
media persons. The net extends to a few intellectuals and some social activists. But this space belongs to captains of industry. The World Social Forum in Porto Alegre is organized by social activists to network with each other and to meet with a select group of political leaders, policymakers, media persons, trade unionists and academics who broadly share the same worldview. But this space belongs to NGOs.

The International Forum for Development, we believe, is different. We hope to create a meeting space for a genuine dialogue between different stakeholders: scholars, parliamentarians, policymakers, social activists, media persons, corporate leaders and trade unions. These groups need to work together if we are to bring about meaningful changes, but they do not talk to each other enough. We aim to provide a space where they can communicate with each other, develop mutual understanding and hopefully develop a common agenda. Concerned scholars are expected to play a catalytic role in the process by presenting state-of-the-art knowledge in accessible forms, highlighting policy issues that deserve more attention and identifying new issues. It will not, however, be an academic forum. The forum will be a shared common space for every stakeholder, which does not belong to any particular subset.

We are convinced it is possible to enhance understanding and develop capabilities by learning from each other. We also believe differences in perceptions and pluralism in thinking, through dialogue, can provide the foundations of alternative policies for, and a new consensus on, development.

IV. FORMAT

This annual meeting is designed as the flagship event of the International Forum for Development. The discussion will focus on a perennial theme and a conjunctural theme. These themes will change from year to year. The perennial theme this year is growth and employment. The conjunctural theme this year is the disguised unilateralism implicit in the trade policies of industrialized countries. It needs to be said that this annual event constitutes a modest beginning.
In the years to come, we hope to diversify our activities so that we can use knowledge, dialogue and outreach for exploring development alternatives. This is, obviously, an ambitious endeavor. We need to recognize that the journey to our destination cannot be telescoped in time. Indeed, we should think of five years as the minimum period of transition before we begin to be recognized as an institutionalized meeting space. Even so, given the strength of our common cause, we are confident that it can be done.

V. ANALYSIS

The following points have emerged from the papers presented and the discussions around them throughout the meeting.

It is rather well known that the last two decades of marketization and globalization have witnessed increasing inequalities across and within countries. While there is some debate on whether individual income distribution on the world scale has become more equal or not—the answer to which critically depends on how one estimates the results of the spectacular growth in China and impressive growth in India over the last two decades—there is little disagreement that inequalities have markedly increased over the last two decades in most countries (including China itself, which has seen a very sharp deterioration in income distribution) and across the world sans China.

This record on inequality looks even more negative when we consider that it has happened in the context of slower and more volatile growth. In the early days of neo-liberal reforms, we were told by proponents that while their reforms may introduce short-term increases in inequalities, they will in the end lift everyone up by accelerating growth and thereby producing more wealth. The sad truth, as we have pointed out, is that these reforms have failed to deliver on their central promise, namely, accelerated growth. And given this growth failure, the poor record of neo-liberalism on income distribution makes us wonder why we have to accept higher inequality if we are not even getting higher growth in return.

Employment is another area where the neo-liberal policies have performed very poorly. During the last two decades, unemployment
has risen, employment has become far less secure and real wages have fallen for many people. In particular, with the casualization of work women have borne disproportionate shares of the burden, as many of them have become main breadwinners while having to continue to perform virtually all the domestic work. In their obsession with low inflation and (internal and external) financial balances, neo-liberal policies have essentially relegated employment to the position of a residual in policy design. In fact, provision of more jobs of decent quality is the only sustainable way to provide decent income, decent work and female empowerment, especially in the context of most developing countries, where social welfare institutions are extremely weak.

The orthodoxy naturally keeps quiet on these embarrassing records, and, when confronted with them, attempts to blame the governments for not trying hard enough—often saying that reforms were not sincerely implemented or that there is still a lot more that needs to be done—or pleads for patience, asserting that the reforms need more time to work their effects. In fact, what needs to be pointed out is that these poor records are inevitable results of the logic behind the neo-liberal reforms, and not the results of poor implementation or insufficient time. Lower investment in physical and human capitals, slower and more volatile growth (punctuated by speculative booms and financial crises), creation of greater insecurity and higher unemployment in the labor market, and the increase in inequalities are all inevitable results of the neo-liberal reforms that emphasize low inflation, financial balances, and “flexible” (and thus short-term oriented) markets.

It is not as if alternative policies that would encourage decent work, social solidarity and long-term oriented productive investments are not known. Development experiences of the more advanced countries, starting from eighteenth-century Britain down to the more recent success cases of South Korea and Taiwan, provide plenty of lessons, if not ready-made solutions, in this regard. However, the use of policies that encourage long-term commitments and social solidarity—which often involves the use of protec-
tion, subsidies and government regulations—is made difficult by the current rules of the game and the balance of power in the world economy.

This is most visible in the area of the international trading system embodied in the WTO. Under the rhetoric of a “level playing field,” the developing countries are denied many policies they need—such as extra protection, greater use of subsidies, additional regulations on foreign investment and weaker intellectual property rights—and are instead put under pressure to open up their markets to the same extent as that found in the developed countries. True, there are some minimal allowances for their conditions under “special and differential treatment,” but these are being rapidly eroded in the name of creating a level playing field. And to make it even worse, the developed countries continue to protect the sectors where they are most vulnerable, such as textiles and agriculture.

In addition to the “unfair” international trading rules embodied in the WTO, the developing countries are subject to further pressures from the developed countries to do even more than what is required under their WTO obligations. The conditionalities imposed by the IMF and the World Bank—as well as donor governments, informal bilateral pressures and various bilateral and regional free trade agreements—all work together to subject developing countries to a “WTO-plus” regime.

Developing countries need more policy space that will allow them to adopt policies that suit their levels of development and other socio-economic conditions. This policy space is often denied on the grounds that developing countries are prone to make bad policy decisions and therefore should be prevented from harming themselves through binding external constraints. The curious thing, though, is that many of these orthodox economists who advocate limiting policy autonomy for the developing countries would vehemently denounce similar restriction on individual autonomy by national governments as unwarranted paternalism. If they truly value choice and autonomy, as they often claim, they should be willing to allow countries to have “the right to be wrong.”
VI. MESSAGES

There are a number of significant messages that have emerged from the discussions at the first annual meeting of the International Forum for Development.

- Employment must be placed center-stage. It should be seen as an objective that has a strategic importance in itself, rather than as a residual outcome of economic growth or economic policies.
- The only sustainable solution for poverty eradication is employment creation, just as it is the only real foundation for decent work.
- The gender dimensions of employment are critical because empowerment of women is an integral part of any process of egalitarian development.
- There is a need to integrate economic and social policies. For this purpose, it is essential to create institutional mechanisms that mediate between economic growth and social development. Safety nets will not suffice.
- For latecomers to development, it is essential to develop capabilities at a micro level and institutions at a meso level.
- It is necessary to redefine the economic role of the state in this age of markets and globalization. Yet, the role of the state is critical if development is to bring about an improvement in the living conditions of people.
- The rules of the game in the world economy, particularly in the sphere of trade but also elsewhere, are unfair. We need fair rules. Indeed, we may need affirmative action for the developing countries in general and the least developed countries in particular.
- Countries that are latecomers to industrialization need policy space in the pursuit of national development objectives. Indeed, countries and people have a right to be wrong so that they can learn from mistakes.
VII. FUTURE

We do not see ourselves as incurable romantics, starry-eyed idealists or even functional pragmatists. In our search for alternatives in development, we seek to blend the desirable with the feasible. Our short-term motivation is to increase consciousness about, and impart a voice to, the poor and the excluded. Our long-term objective is to change thinking, exercise influence and ultimately shape outcomes. As a group of concerned scholars and concerned citizens, we do not seek to preach to the converted. Instead, we hope to reach out in persuasion. It is only natural that we begin on such a modest note. And beginnings are always difficult. We sincerely hope that an ever-widening circle of concerned citizens at the International Forum for Development can spread the message that a better world is possible.
Part 1:
Development and Globalization
“We believe that the central challenge we face today is to ensure that globalization becomes a positive force for all the world’s people,” reads the fifth paragraph of the United Nations Millennium Declaration (United Nations, 2000). Although globalization reflects technological advances and economic forces, it can be molded by society and, particularly, by democratic political institutions. In fact, the form that globalization has been taking has been largely determined by explicit policy decisions.

In this sense, the most disturbing aspect is the uneven and unbalanced character of the current phase of globalization and of the international policy agenda that accompanies it. The latter reproduces the traditional asymmetries in the world economy and creates new ones. There are four issues that dominate the current economic agenda: free trade, intellectual property rights, investment protection and financial and capital account liberalization. In the latter case, certain additional conditions have been superimposed as a result of recent crises: It should be appropriately sequenced, and priority should be given to long-term flows and institutional develop-
ment. Moreover, in the area of international trade, liberalization is incomplete and asymmetric: Various goods of special interest to the developing countries are subject to the highest levels of protection, and in the case of agriculture, to subsidies in the industrialized countries.

On the other hand, major issues have been left out of the international economic agenda: the mobility of labor, particularly unskilled labor; international norms regarding taxation, especially on capital, which is essential to guarantee an adequate contribution of this highly mobile factor to public sector financing; the formulation of truly international norms on competition and codes of conduct applicable to multinational corporations; the design of effective instruments to ensure an adequate technological transfer to developing countries; and compensatory financing to assure the inclusion of those countries and social groups that tend to fall behind in the process of globalization.

The preceding reflects, in turn, the most important asymmetry: that which exists between the rapid globalization of (some) markets and the relative weakness of the international social agenda, which has its best expression in the declarations and plans of action of the United Nations Conferences and Summits. The social agenda has to cope, in turn, with weak accountability and enforcement mechanisms, the limited supply of Official Development Assistance and the conditionality that characterizes international financial support.

In broader terms, it is increasingly recognized that globalization has made more evident the need to provide political, social, economic and environmental “global public goods” (Kaul et al., 2002), in view of the fact that, with the growing interdependence of nations, many areas of public interest that were previously national (and, in some cases, local) are becoming spheres of global attention. Nevertheless, there is an undisputable contrast between the recognition of this fact and the weakness of the international structures and limited resources allocated to provide these global public goods.

This paper provides an analysis of some of the challenges faced in building a more balanced globalization. It is divided into three sec-
tions, the first of which is this introduction. The second focuses on economic inequalities and asymmetries and the international schemes and national policies needed to overcome them. The third deals with the broader relations between globalization and democracy and between globalization and social equity.

II. WORLD ECONOMIC INEQUALITIES AND ASYMMETRIES

1. Global inequalities
The extensive literature on economic growth makes clear that the world has experienced a long term divergence in the levels of per capita incomes among countries over the past two centuries. This trend was particularly strong in the nineteenth century and the first half of the twentieth century. It slowed down between 1950 and 1973, experienced a reversal between 1973 and 1980, but has resumed since then. Using levels of per capita income of the 142 countries included in the historical series of Angus Maddison (2003), it is possible to estimate that the average logarithmic deviation of this variable (one of the traditional measures of inequality) increased from 0.54 in 1980 to 0.65 in 2001. Divergence is stronger and more persistent if we focus on the ratio between per capita income of the industrialized countries and the poorest region of the world today, sub-Saharan Africa. This ratio was already high in 1973 and nearly doubled since then (Figure 1).

FIGURE 1: Increasing international inequalities

Source: Author estimates based on Maddison (2003)
The analysis of the same data source brings to light another and equally important phenomenon: the marked and growing dispersion of the rates of growth of the developing countries during the last quarter of the twentieth century—that is to say, the coexistence of “winners” and “losers” among them. In fact, for the same sample, the standard deviation of the rates of growth per capita of developing countries increased from 1.8 in 1950-73 to around 3.0 since 1973 (Figure 2). Furthermore, this trend is widespread, as it affects all regions, and low-income as well as middle-income countries.

The divergence in per capita incomes has been accompanied by a fairly broad trend towards increasing inequality within countries. According to Cornia (2004, Part I), 48 out of 73 countries for which information is available experienced a deterioration of income distribution during the last decades of the twentieth century; these 48 countries contain 87.5 percent of the population of the sample of 73 countries (Table 1). Furthermore, in four out of five countries that experienced a deterioration of income distribution, the worsening of the Gini coefficient was at least equivalent to three percentage points, a relatively large change. On the contrary, only nine countries, with 2.7 percent of the population, experienced a clear improvement in income distribution, and in the rest income distribution remained essentially stable. According to this study, inequality tended to increase, sometimes markedly, in a large group of industrial countries.
in Central and Eastern Europe and in Latin America. Asian countries, among which China stands out, have increasingly shared in this trend. Africa is the only continent without a clear tendency of this sort, as a result of opposite patterns experienced by different countries in the continent.

The reasons for the worsening income distribution within countries continue to be a subject of heated debate. The combination of the adverse distributive effects of market reforms (or at least of some of them) and the simultaneous weakening of the institutions of social protection, including the growing difficulties experienced by governments in providing effective social protection in a globalized world economy, offers the best explanation (Cornia, 2004). The increasing differentials in labor income according to skill levels provide a complementary explanation, perhaps the one that enjoys greater consensus among analysts. A third force, which has been subject to less attention, is the increasing asymmetry between the international mobility of some factors of production (capital and highly skilled labor) and the restrictions on the mobility of other factors (unskilled labor), which generate forces that distribute income to the disadvantage of the latter (see below).

| TABLE 1: Changes in income inequality within countries, 1960s to the 1990s |
|-----------------------------------------------|------------------|--------------------|------------------|------------------|
|                                               | Developed       | Developing        | Transition        | Total            |
|                                               | countries       | countries         | economies         |                  |
| A. Number of countries                        |                  |                    |                  |                  |
| Rising inequality                             | 12               | 16                 | 20               | 48               |
| Constant                                      | 4                | 10                 | 2                | 16               |
| Falling inequality                            | 2                | 7                  | 0                | 9                |
| Total                                         | 18               | 33                 | 22               | 73               |
| B. Percent of population a/                   |                  |                    |                  |                  |
| Rising inequality                             | 13.3             | 66.7               | 7.5              | 87.5             |
| Constant                                      | 2.3              | 7.3                | 0.3              | 9.8              |
| Falling inequality                            | 1.8              | 0.9                | 0.0              | 2.7              |
| Total                                         | 17.4             | 74.8               | 7.7              | 100.0            |

a/ Percent of 73 countries population, that represent 78.5% of world population. Source: Based on Cornia (2004), Table 2.8 and population data from the United Nations.
Since the 1980s, these two forces—the divergence in per capita income levels among countries and the growing inequality in income distribution within countries—have been counterbalanced by the rapid economic growth of China, and, to a lesser degree, India, the two most populous poor countries in the world. The trend in the distribution of income among the world’s citizens thus depends on the statistical methodologies used to aggregate individual country distributions to estimate a world income distribution. Accordingly, different studies have reached different conclusions about the nature of that trend over the last decades of the twentieth century.

Nonetheless, four conclusions can be drawn from this literature. The first and most important is that world inequality is appalling and remains at or very close to its historic peak. The second is that if there has been deterioration in the world distribution of income, it has been slower than that which characterized the nineteenth century and the first half of the twentieth century, during which the gap between per capita income of developed countries and developing countries increased markedly (see, in particular, Bourguignon and Morrison, 2002). The third is that any estimated improvement in world income distribution is exclusively due to the rapid growth of China and, to a lesser extent, India. Indeed, according to Berry and Serieux (2002), if we exclude the effect of the rapid growth of these two countries, there was a sharp increase in world inequality, due to the joint effect of increased intra-country inequalities and the adverse distributive effect of faster population growth in poorer countries. Finally, independent of the trend in the overall indicators of world income distribution, the richest 10 percent of the world population has increased its share of world income. Berry and Serieux (2002), who estimate that world income distribution improved in 1980–2000, also calculate that the share of the richest decile in world income increased from 46.6 to 49.3 percent during the same period.

Taken as a whole, these studies also indicate that there was a major redistribution of world income over the last two decades of the twentieth century: China and India, where a large proportion of poor peo-
ple live, as well as the relatively rich households of industrial countries have gained in world income distribution, while the poor from sub-Saharan Africa and most poor and middle-income recipients from the less successful middle-income countries and transition economies have clearly lost. Furthermore, given the critical importance of China and India in global estimates, it is important to emphasize that their rapid economic growth can hardly be understood as the result of the ability of the globalization process to redistribute world income more equitably. These two experiences, as well as those of other Asian NICs, certainly reflect the fact that world trade has opened opportunities to developing countries, particularly to exporters of manufactures and services. However, these success stories of integration into the global economy have been matched by several failures.

In summary, existing studies underscore the widespread increase of inequality within countries that characterizes the current global order, as well as the fact that the opportunities that it provides to different countries are distributed very unevenly. Thus, “virtuous” and “vicious” circles have been put in place in the world over the past decades, resulting in some (certainly major) “winners” but also in an even larger set of “losers.” Several factors may be at work here, particularly agglomeration forces\(^6\) and the differential effects of major international shocks on more vulnerable economies. Three shocks are particularly relevant in this regard: the debt crisis of the 1980s, the strong downward trend of commodity prices since then\(^9\) and the global financial repercussions of the 1997 Asian crisis.

2. Economic asymmetries in the global order
The growing disparities in the levels of development among countries indicate that, although domestic economic, social and institutional factors are obviously important, economic opportunities are significantly affected by the position that countries occupy within the global hierarchy. This implies that rising up on this international ladder is a difficult task. The fundamental international asymmetries largely explain why the global economy is essentially not a “level playing field.”
These asymmetries are of three kinds (Ocampo and Martin, 2003). The first is associated with the greater macroeconomic vulnerability of developing countries to external shocks, which has tended to increase with the tighter integration of the world economy. The nature of this vulnerability has been changing, nevertheless, in the last decades. Thus, although the transmission of external shocks through trade remains important, financial shocks have come to play a more prominent role, revisiting patterns that have been observed in the past in many developing countries, especially during the boom and financial collapse of the 1920s and 1930s.

In this sense, macroeconomic asymmetries are associated with the fact that international currencies are the currencies of the industrial countries and with the asymmetric features of capital flows and their relation to macroeconomic policy in the industrial and developing world. Capital flows are pro-cyclical in most OECD and developing countries, but the volatility experienced by the latter is more marked. Even more importantly, whereas macroeconomic policy in developed countries tends to be counter-cyclical and independent of the capital account cycle, in developing countries pro-cyclical macroeconomic policies tend to reinforce the capital account cycle. These patterns indicate that industrial countries have more room for maneuver to adopt counter-cyclical macroeconomic policies (particularly in the United States, which issues the major international currency). In contrast, developing countries generally lack that room for maneuver because they are subject to highly volatile financial flows, because pro-cyclical macroeconomic policies tend to amplify rather than smooth out the capital account cycle, and market players expect and evaluate authorities on their ability to adopt a pro-cyclical stance.

The second asymmetry is derived from the high concentration of technical progress in the developed countries. The diffusion of technical progress from the source countries to the rest of the world remains “relatively slow and uneven” according to Prebisch’s (1950) classical predicament. This reflects the prohibitive costs of entry into the more dynamic technological activities, including the obstacles that developing countries face in technologically mature sectors, where oppor-
tunities for them may be largely confined to attracting multinationals that control the technology and global production and distribution networks. In its turn, technology transfer is subject to the payment of innovation rents, which have been rising due to the generalization and strengthening of intellectual property rights. The combined effect of these factors explains why, at the global level, the productive structure has exhibited a high and persistent concentration of technical progress in the industrialized countries, which thus maintain their dominant position in the most dynamic sectors of international trade and their hegemony in the establishment of large transnational enterprises.

The third asymmetry is associated with the contrast between the high mobility of capital and the restrictions on the international movement of labor, particularly of unskilled labor. This asymmetry is a characteristic of the present phase of globalization, since it was not manifested in the nineteenth and early twentieth centuries (a period characterized by large mobility of both capital and labor) nor in the first 25 years following the Second World War (a period in which both factors exhibited very little mobility). As has been pointed out by Rodrik (1997), these asymmetries in the international mobility of the factors of production generate biases in the distribution of income in favor of the more mobile factors (capital and skilled labor) and against the less mobile factors (less-skilled labor) and, in turn, affect relations between developed and developing countries in as much as the latter have a relative abundance of less-skilled labor.

3. Global asymmetries and international economic structures
Since the creation of the United Nations Conference on Trade and Development (UNCTAD), the need to correct the asymmetries that characterized and continue to characterize the international economic system has been explicitly recognized. The commitments concerning the flow of Official Development Assistance and “special and differential treatment” for developing countries in trade issues were some of the partial, although relatively frustrating results of this effort to build a “new international economic order.” This vision has been
radically eroded in the last decades and has been replaced by an alternative paradigm according to which the basic objective of the international economic system should be to ensure a uniform set of rules—a level playing field—leading to the efficient functioning of free market forces.

It is important to emphasize that, contrary to this trend, in the area of sustainable development new principles were agreed to at the outset of the 1990s, notably Principle 7 of the Declaration of the Conference on the Environment and Development that took place in Rio de Janeiro in 1992 (commonly known as the Earth Summit), relative to “common but differentiated responsibilities” of developed and developing countries.

In the new vision of the international economic system that emphasizes the need for a level playing field, the essential gains for the developing countries lie in the eventual dismantling of protectionism of “sensitive” sectors in industrialized countries, in the guarantees that export sectors derive from an international trading system with clear and stable rules, and in the design of preventive macroeconomic policies which serve as “self-protection” against international financial volatility. The correction of the international asymmetries is only confined to the recognition of international responsibility towards least-developed countries, replicating at an international level the vision of social policy as a strategy that focuses state activities on the poorest segments of the population.

Even though all these actions are desirable, would they be sufficient in themselves to generate a greater convergence in levels of development? In light of the previous considerations, the answer is probably “no.” The application of the same measures in very different situations can even aggravate existing inequalities. Moreover, “leveling the playing field” implies restrictions on the developing countries that the industrial countries themselves never faced in previous periods of their history: standards of intellectual property protection, which are those of countries that generate technology rather than those which were adopted by countries that copied technology, and limitations on policy options for promoting new productive sectors for either the domes-
tic or the external markets (Chang, 2002). Thus, the concept of “common but differentiated responsibilities” of the Rio Declaration and the already classic principle of “special and differential treatment” incorporated in the agenda of international trade negotiations are more appropriate guidelines for building a more equitable global order than the “leveling of the playing field,” the norm that has guided efforts to reform the international economic system in recent decades.

These considerations lay down the essential elements that should guide international economic reform vis-à-vis the developing countries (Ocampo and Martin, 2003). The first of these asymmetries suggests that the essential function of the international financial institutions, from the perspective of the developing countries, is to compensate for the pro-cyclical impact of financial markets, smoothing financial boom and bust at its source through adequate regulation, and providing a larger degree of freedom for countries to adopt counter-cyclical macroeconomic policies. This implies, in turn, adequate surveillance during boom periods to avoid accumulating excessive macroeconomic and financial risks, and adequate financing during crises to smooth the required adjustment in the face of “sudden stops” of external financing. An additional function, which is equally essential, is to act as a countervailing force to the concentration of credit in private capital markets, making resources available to countries and economic agents that have limited access to credit in international capital markets.

With respect to the second asymmetry, the multilateral trade system must facilitate the smooth transfer to developing countries of the production of primary commodities, technologically mature manufacturing activities and standardized services. It should, therefore, avoid erecting obstacles to such transfers through protection or subsidies. Moreover, this system must also accelerate developing countries’ access to technology and ensure their increasing participation in the generation of technology and in the production of goods and services with high technological content.

In light of the problems that developing countries face in ensuring a dynamic transformation of their productive structures, a “special and differential treatment” is required, particularly in two critical
areas: (i) regimes for intellectual property protection that avoid creating excessive costs for developing countries and limiting the modalities through which the transfer can be made and which provide instead clear incentives for the transfer of technology towards them; and (ii) instruments to promote new exports (“infant export industries”), which foster diversification and increase their value added. All this requires, obviously, a search for the appropriate instruments in order to avoid a sterile competition among countries to attract footloose industries.

Lastly, to overcome the third asymmetry, labor migration must be fully included in the international agenda through a globally agreed-upon framework for migration policies and strict protection of human and labor rights of migrants, complemented with regional and bilateral frameworks and negotiations. Moreover, such agreements must envisage complementary mechanisms to facilitate migration, such as the recognition of educational, professional and labor credentials; the transferability of social security benefits, and a low cost for transferring remittances.

A “development friendly” international system should start by overcoming the basic asymmetries of the global system, but cannot ignore the fact that the responsibility for development resides in the first instance with the countries themselves. This has been reiterated in numerous international declarations, particularly in the United Nations Conference on Financing for Development (United Nations, 2002). This principle also responds to an old postulate of development literature: that institutional development, the creation of mechanisms of social cohesion, and the accumulation of human capital and technological capacities (“knowledge capital”) are essentially endogenous processes. To use a term coined by Latin American structuralism, in all these cases development can only come “from within” (Sunkel, 1993). There are no universal models and there is, therefore, vast scope for institutional learning and diversity and, as we will see below, for the exercise of democracy.

However, the previous analysis implies that such a development-friendly international system must provide enough room for the
adoption of the development strategies that developing countries consider adequate to their economic circumstances—“policy space,” to use the terminology of UNCTAD XI, that took place in June 2004 in São Paulo. Such policy space is particularly critical in the design of policies and strategies in three areas: (i) macroeconomic policies that reduce external vulnerability and facilitate productive investment, (ii) active productive development strategies aimed at developing system-wide competitiveness, and (iii) ambitious social policies designed to increase equity and guarantee social inclusion.14

III. A MORE BALANCED GLOBALIZATION

1. The long road to better global governance

As the World Commission on the Social Dimension of Globalization (2004) has indicated, the road to a balanced globalization inevitably lies in better global governance. However, this road is long and rocky since the asymmetries that characterize the present globalization and the resulting distributive tensions reflect the intrinsic characteristics of politics and the political economy of the world today.

In fact, the imbalance of the current globalization agenda reflects the greater influence exerted thereon by the more powerful states and the large multinational firms. It is also the result of the disorganization of other actors, particularly developing countries, in international debates. This behavior is linked not only to the weakening of historical mechanisms of collective action of the developing countries (such as the Group of 77)15 but also to the “policy competition” that globalization itself has created: the incentive for each country to show its attractiveness to investors in an era of capital mobility and greater susceptibility to relocation of production.

This situation is also affected by an element of politics and political economy: the resistance of the majority of countries to giving up their economic sovereignty to international organizations. Under the strong market forces that characterize globalization and weaken nation-states, as well as the unilateral liberalization processes simultaneously undertaken by countries, regulations of markets have weak-
ened worldwide. Many analysts see this as progress, but it is also a source of serious distortion and risk. In addition, although open regionalism is one of the traits of the current globalization process and has led to integration efforts in many regions of the developing world (such as in Latin America, Southeast Asia and, more recently, Africa), these efforts have thus far not resulted in strong coalitions among developing countries. In fact, the European Union aside (and, in this case, only in a limited way), countries are not ready to give up their sovereignty even to regional organizations.

These characteristics of politics and political economy have had important consequences for international reform. The most obvious is that efforts towards substantial reform are weak. Furthermore, they have prevented a more balanced negotiation process, thus undermining or even ignoring the interests of some actors. Hence, the asymmetries in global power relations and the high cost of establishing international coalitions to compensate for them have taken on greater importance.

The absence of a strong drive towards institution building at the international level implies that the institutions thus far created at the national level will not exist at the global level or will only have limited functions. Given the likelihood of incomplete international arrangements, developing countries should continue to claim autonomy in areas of critical importance, particularly in the definition of strategies of economic and social development and, as we have seen, adequate “policy space” to implement them. Moreover, as we see below, national autonomy in this area is the only system coherent with the promotion of democracy at the global level.

A final implication of the aforementioned analysis is that no international architecture is neutral in terms of the balance of power in international relations. In this regard, an international system that depends exclusively on a few global institutions will be less balanced than a system that relies also on regional institutions. The positions of countries lacking power at the international level will improve if they actively participate in such regional schemes. In fact, these schemes offer levels of autonomy and mutual assistance that countries would
otherwise not be able to obtain in isolation. Therefore, the international order should offer ample room for the functioning of strong regional institutions respectful of a global order based on clear rules—in other words, a system of “open regionalism.” In fact, building a strong network of regional institutions could be the best way to gradually build a better international order.

**2. Globalization and Democracy**

Despite the strength of the asymmetries that characterize the world economic system and the distributive tensions that it generates, the current phase of globalization is a multidimensional phenomenon that has also included the gradual spread of common ethical principles and international social objectives. These principles have been sanctioned in international declarations and agreements on human rights, and in the declarations and plans of action of the United Nations Conferences and Summits, including in particular the Millennium Declaration (United Nations, 2000) and the Millennium Development Goals that have derived from it. These principles and international goals represent, in a deep sense, the “social dimensions of globalization.” These processes are also rooted in the long history of struggle by international civil society for human rights, social equity, gender equality, protection of the environment and, more recently, globalization of solidarity and the “right to be different” (cultural diversity).

This “globalization of values” (ECLAC, 2000; Ocampo and Martin, 2003) has been instrumental in spreading democratic principles and a broad vision of citizenship, based on the spread of both civil and political rights, as well as economic, social and cultural rights—i.e., on a “rights-based” approach to the design of political as well as economic and social institutions. However, the simultaneity of this process with the liberalization of market forces has generated tensions without creating mechanisms to attenuate them. The main reason for this is that the process of globalization, while supporting the recent spread of democracy and the establishment of international social objectives, has also eroded the capacity for action by nation-states. It has kept the complex task of sustaining social cohesion in the hands
of nation-states, but has constrained at the same time their room for maneuver. Moreover, the necessary space required by democracy to engender diversity has been reduced as a result of the homogeneity of norms and the strong weight of conditionality in international financial assistance.

In this sense, the absence of a true internationalization of politics is the major paradox of the current globalization process. In other words, the simultaneous growth of democratic forces and distributive tensions has not been accompanied by the strengthening of the political institutions that would reduce the tension between them. Although there are incipient instances of global citizenship that take place in the form of struggles by international civil society, their capacity to affect the course of globalization still depends on their influence on national political processes.

This has deep implications for the international order. In the first place, it implies that it is necessary to create democratic spaces of a global character. However, this process will be necessarily slow and incomplete. Therefore, as long as the nation-state remains the main space for the expression of political citizenry, the promotion of democracy as a universal value will only make sense if national processes of representation and participation are allowed to determine economic and social development strategies and to mediate the tensions created by globalization. This coincides with the idea that institutional development, social cohesion and the accumulation of human capital and technological capacity ("knowledge capital") are essentially endogenous processes (see Section II.3).

The support for these endogenous processes, the respect for diversity and the formulation of norms that would facilitate it are essential for a development-friendly international democratic order. This means, therefore, that the international order should be strongly respectful of diversity, obviously within the limits of interdependence. It also implies that an essential function of international organizations is to support national strategies that contribute to reducing, through political citizenry, the strong tensions that exist today between the principle of equality and the functioning of globalized markets.
3. International social goals and Official Development Assistance

Within a rights-based approach, the construction of a global social agenda should recognize that all members of society are citizens and, as such, are bearers of economic, social and cultural rights. The international declaration and covenants of human rights, as well as international agreements adopted at United Nations Conferences and Summits, should thus be considered an initial definition of the concept of global citizenship.

However, in this respect, there has not been a full transition from domestic to international responsibilities. In fact, respect for human rights and the responsibility of achieving social objectives still remains at the national level. Moreover, the execution of these obligations and commitments still lies with the nation-state and does not explicitly include other social agents. Lastly, as of now, there are no clear mechanisms for guaranteeing that these rights and international commitments are respected by nation-states.

One essential activity in this field is the production, dissemination and analysis of information on the situation of economic, social and cultural rights, and on the provision of “public goods” and “goods of social value,” as well as on the fulfillment of objectives agreed upon at world conferences and summits. These periodic evaluations should be discussed at representative national forums, with active participation by parliaments and civil society. A process of this type would contribute to creating a culture of responsibility for meeting international objectives and commitments, and to adjusting domestic public policies accordingly. It would thus help building strong political accountability for international commitments.

The political visibility and the mechanism designed to evaluate progress towards the Millennium Development Goals represent major progress in this regard. It would be important to build on this experience and create new and broader mechanisms to promote accountability that would eventually lead to an integrated evaluation covering the declaration and covenants of human rights and other internationally agreed social rights (e.g., the principles and fundamental rights to employment, agreed upon at the International Labour
Organization, and the rights of children, women and ethnic groups) and the closely related commitments reached at global Conferences and Summits of the United Nations.

In some cases, this political accountability can gradually make room for the possibility of citizens being able to *judicially demand* the fulfillment of their economic, social and cultural rights and of other international social commitments in competent national and international courts. The European Union has been the only region in the world where this process has been initiated. In all cases, the obligations of states must correspond to the degree of development of countries and, in particular, with their ability to reach goals that can indeed benefit *all* citizens. This avoids both voluntarism, whose more ambitious social goals may exceed the means of achieving them and thus generate frustration, as well as populism, whose efforts to satisfy popular demands beyond fiscal means can generate adverse macroeconomic effects.

At the same time, it is important to recognize that the responsibility for the comprehensive enforcement or implementation of human rights and social goals goes beyond the aegis of the state. For this reason, the international community has moved towards various innovative initiatives, including the concept of corporate social responsibility. One concrete example of such initiatives is the Global Compact of the United Nations, through which the private firms that participate in the program commit themselves to voluntarily promote human rights in their areas of activity, to respect basic labor rights, to protect the environment and, more recently, to combat corruption.¹⁷ This process has been accompanied by private initiatives, both in the corporate sector and in social movements of diverse origins.¹⁸ These principles and commitments of corporate social responsibility have begun to be pursued on a regular basis by different institutions. It is worth noting, however, that there is still a great deal of controversy between those who argue for compulsory corporate responsibility schemes (mainly NGOs) and those (private firms) that prefer voluntary standards that will be gradually extended through emulation.

On the other hand, the existence of significant global inequalities
and asymmetries means that economic globalization will succeed in achieving convergence in the levels of development between countries only if accompanied by resource flows explicitly aimed at that objective. The European Union, through its policy of “social cohesion,” has undoubtedly provided the institutional mechanisms through which this principle has been applied most clearly. It is indicative of the underlying political philosophy of these arrangements that the deepening of economic integration in the last decade of the twentieth century was accompanied by the strengthening of its cohesion policy (Marín, 1999). There is, however, no similar experience outside the European context. For this reason, as some analysts have argued, it would be desirable to extend this experience to other regional arrangements.19

At the global level, the critical instrument for the achievement of social goals has been and will continue to be Official Development Assistance (ODA). Such assistance should be provided in accordance with the international commitments agreed to at the United Nations (to allocate ODA equivalent to 0.7 percent of the Gross National Income of developed countries) and with the basic criteria agreed to by the international community in the 2002 Monterrey Conference on Financing for Development: to give priority to the fight against poverty and to the ownership of socio-economic development policies by the countries that adopt them (United Nations, 2002).

NOTES

1. As pointed out in Section III (see also footnote 16), the concept of “global public goods” may be understood as encompassing “goods of social value” that have been determined by international conferences and summits.

2. See, in particular, Table 2.8 of Cornia’s book. The data on population come from the United Nations and refer to the year 2000. The percentages were estimated in relation to the population of the 73 countries reported in that table, where 78.5 percent of the world’s population is concentrated.

3. The trend in income inequality in OECD countries also comes clearly from the analysis of pay inequality in Galbraith and Kum (2004), who do not find, however, such a clear trend of pay inequality in developing countries, except in the period
from the mid-1980s to the mid-1990s. It can be argued, however, that the methodology and data (industrial statistics) used by these authors is more applicable to industrialized than to developing countries.

4. There are two issues that are critical in regard to the statistical methodologies: (1) the use of market prices vs. purchasing-power estimates of national income (as well as the specific PPP estimate used) and (2) whether the information provided by household surveys is exclusively used or, alternatively, it is combined with that provided by the national accounts on national income and consumption.

5. Among the studies which claim that there was a deterioration in world income distribution in recent decades, we could include Dikhanov and Ward (2001) for the period 1970-1999, Bourguignon and Morrison (2002) for 1970-1992 using the Theil inequality index (the other two indexes used by these authors show no clear trend during that period) and Milanovic (2002) for 1988-1993. See also the comments on Galbraith and Kum (2004) in footnote 3. The opposite conclusion is reached by Berry and Serieux (2002 and 2004), Bhalla (2002), Sala-i-Martin (2002) and Sutcliffe (2004). The last study provides a very useful comparison of different estimates of world inequality.

6. The effect of this rapid growth in China and India comes strikingly in the different calculations of Berry and Serieux (2004).

7. This is also the conclusion of the estimates of Bourguignon and Morrison for 1980-1992, which indicate that the share of the richest decile in world income increased from 51.6 to 53.4 percent.

8. The process of agglomeration forces was emphasized in the past by the literature on regional economics and, more recently, by that on economic geography (see, for example, Krugman, 1995).

9. See Ocampo and Parra (2003). This downward trend of commodity prices has been recently, but only partially, counterbalanced by the effects on world commodity markets of the rapid growth of China.

10. This international currency phenomenon has come to be called the “original sin.” See an analysis of this issue and a contrast with competing concepts in Eichengreen et al. (2003).

11. See Kamisky et al. (2004), who call this feature of developing countries the “when-it-rains-it-pours syndrome.”


13. See, for example, the first report of the Secretary-General of UNCTAD (Prebisch, 1964).
14. For a more extended analysis of the issues raised in this section, see Ocampo (2002) and Ocampo and Martin (2003), Chapter 5.

15. A recent development has been, however, the rise of new groupings of developing countries that cross regions and have had an important influence on trade negotiations (e.g., the G-20 led by Brazil, and the coalition of ACP countries and LDCs).

16. The concept of “goods of social value” captures what in the literature on welfare economics have been called “merit goods.” Thus, “public goods” focus on the interdependence of consumers and other economic agents (in the case of pure public goods, on the fact that consumption is collective), whereas “goods of social value” emphasize the decision of society to provide certain goods to all citizens, and is thus akin to the concept of economic and social rights. Although the differentiation between these concepts makes sense in the context of welfare economics, the common use of the term “public goods” in social and political analysis usually encompasses both. Thus, as pointed out in footnote 1, the concept of “global public goods” should be understood as including international social objectives, in particular the Millennium Development Goals.

17. See www.unglobalcompact.org

18. Among relevant initiatives, there are directives for multinational enterprises prepared by the OECD in 2001, the Dow Jones Sustainability Index, the international code on environmental management (ISO14001) and the Corporate Responsibility Index promoted by the British organization Business and the Community and associated with the British stock-exchange index (FTSE).

19. See, for example, Bustillo and Ocampo (2004) in relation to the application of this framework to a possible Free Trade Area of the Americas.

REFERENCES


The Priority of Human Development

Gustav Ranis & Frances Stewart

I. INTRODUCTION

Since 1990, with the publication of the United Nations Development Programme’s first Human Development Report, the concept of Human Development has been strongly advocated as the central objective of development, in place of economic growth. Its intellectual antecedents may be traced to Sen’s concept of capabilities and the earlier basic needs approach. Although mainstream thinkers sometimes acknowledge the concept of human development, economic growth generally remains their prime policy objective. This is one important reason for exploring the relationship between the concepts of Human Development (HD) and economic growth (EG), drawing policy implications from the analysis.

The first Human Development Report stated that, “The basic objective of development is to create an enabling environment for people to enjoy long, healthy and creative lives” (UNDP, 1990, p. 9), and defined human development as “a process of enlarging people’s choices” (p. 10). This definition is, of course, very broad. For the pur-
pose of empirically exploring the links between HD and EG, we need, for now, to narrow it down. We shall consider the HD of a country as consisting of the health and education of its people, recognizing that this is very much a reductionist interpretation.

Clearly, there exists a strong connection between EG and HD. On the one hand, EG provides the resources to permit sustained improvements in HD. On the other, improvements in the quality of the labor force are an important contributor to EG. Although many observers accept that economic growth affects human development, and that human development (interpreted as “human capital”) affects economic growth, the important implications of the interrelations between the two are rarely taken into account. Yet, it is important to understand the full implications of this two-way linkage because this affects both analysis and policy.

In this paper, we first identify the major links between EG and HD (Section II). Then we present some empirical cross-country evidence on these links (III). Section IV presents a typology of country cases, some representing the mutual enhancement of HD and EG and some demonstrating asymmetric performance, followed by an investigation of the movement of countries from one category to another over time. Finally, Section V briefly reflects on the implications for policy.

II. THE TWO CHAINS
We concentrate on two causal chains, one leading from EG to HD (Chain A), the other from HD to EG (Chain B). The two chains are pictured in Figure 1.

1. Chain A: From EG to HD
GNP contributes to HD through household and government activity, community organizations and NGOs. The same level of GNP can lead to very different performance on HD according to the allocation of GNP among and within these actors.

Households’ propensity to spend their income on items that contribute most directly to the promotion of HD, e.g., food, potable water, education and health, varies, depending on the level and distribution
of income across households as well as on who controls the allocation of expenditure within households. In general, as the incomes of the poor rise, the proportion of income spent on HD items increases. Hence HD expenditures are likely to rise as incomes of poor households increase. This means that higher and more equally distributed growth is likely to enhance HD expenditures. This is shown by much empirical evidence. For example, one estimate suggests that if the distribution of income in Brazil were as equal as Malaysia’s, school enrollments among poor children would be 40 percent higher. There is also substantial evidence that greater female control over household expenditure increases the allocation to HD items. In the Ivory Coast, for instance, an increase in women’s share of households’ cash income was shown to be associated with significantly higher spending on food and reduced spending on alcohol and tobacco.  

Turning to the government, the allocation of resources to improving HD is a function of total public sector expenditure, how much of this flows to the HD sectors and the way in which it is allocated within these sectors. This can be expressed in the form of three ratios:  

- the public expenditure ratio, defined as the proportion of GNP spent by the various levels of government; the social allocation ratio, defined as
the proportion of total government expenditure going to the HD sectors; and the priority ratio, defined as the proportion of total HD-sector expenditure going to priorities within these sectors. To clarify, within the HD sectors, those expenditures that are clearly much more productive in terms of achieving advances in HD than others are defined as such as priorities; for example, basic education, especially at an early stage of development, is generally recognized to have a larger impact than tertiary education on HD. But the precise definition of what constitutes a priority area will inevitably vary according to a country’s stage of development, rendering this third ratio more arbitrary than the other two. There exist very large variations across countries in each of these ratios, which means that the same level of GNP may be associated with very different levels of government spending on HD priorities.

The significance of public-expenditure choices for improving HD is illustrated by a comparison between Kenya and Malawi. In the 1980s, a similar proportion of national income went to public expenditure (27 percent in Kenya, 30 percent in Malawi) but Kenya had a significantly higher social allocation ratio (47 percent compared to 35 percent) and priority ratio (34 percent compared to 14 percent) so that the proportion of GDP going directly to HD-improving priorities in Kenya was over three times that of Malawi (5.1 percent compared to 1.5 percent).

Finally, NGO or other civil society activity is typically heavily oriented towards HD objectives (e.g., projects generating incomes for the poor and spending on schools, nutrition and health projects). Although in most contexts NGOs play a supplemental or even marginal role, in a few countries (e.g., BRAC in Bangladesh, and the “Comedores Populares” in Peru) they appear to represent a major source of HD enhancement.

A further important link in Chain A is the effectiveness of these expenditures in raising HD levels. This is represented by the “Human Development Improvement Function.” An example of one important input into this production function is female education, which has been shown by abundant evidence as tending to improve infant sur-
vival and nutrition. Research conducted in Ghana has shown that while in rural areas the provision of basic health services increases child health and survival significantly, the evidence is less clear on urban services.

It is clear from this discussion of the various links in the EG–HD chain that, in general, we expect important causal connections to exist between the economy and HD achievements, but these connections are not automatic. The strength of the links in Chain A varies according to a large range of factors, including the structure of the economy, the distribution of income and the policy choices made.

2. Chain B: from HD to EG
Turning to Chain B, from HD to EG, higher levels of HD, in addition to being an end in themselves, affect the economy through enhancing people’s capabilities and consequently their creativity and productivity. Ample evidence suggests that as people become healthier, better nourished and educated they contribute more to economic growth through higher labor productivity, improved technology and higher exports.

Numerous studies indicate that increases in earnings are associated with additional years of education, with the rate of return varying with the level of education. Analysis of the clothing and engineering industries in Sri Lanka showed that the skill and education levels of workers and entrepreneurs were positively related to the rate of technical change of the firm. Moreover, in agriculture, evidence suggests positive effects of education on productivity among farmers using modern technologies. In Thailand, farmers with four or more years of schooling were three times more likely to adopt fertilizer and other modern inputs than less educated farmers.

The “new growth theories” aim to endogenize technical progress by incorporating some of these same effects, emphasizing education as well as learning and research and development (R&D). According to Lucas (1988), for example, the higher the level of education of the workforce the higher the overall productivity of capital because the more educated are more likely to innovate, and thus affect everyone’s
productivity. A complementary view is that technical progress depends on the level of R&D in an economy. Again, education plays a key role, both in contributing to R&D and via interactive learning.16

There is also a positive feedback from improved education to greater income equality. As education becomes more broadly based, low-income people are better able to seek out economic opportunities, which improves income distribution over time. For example, a study of the relation between schooling, income inequality and poverty in 18 countries of Latin America in the 1980s concluded that “clearly education is the variable with the strongest impact on income equality.”17 Improved income distribution, in turn, has been found to be positively associated with EG, although the finding is contested.18

Improved health and nutrition also have been shown to have direct effects on labor productivity, especially among poorer individuals.19 For example, calorie increases often have been shown to raise productivity, including among farmers in Sierra Leone, sugar cane workers in Guatemala and road construction workers in Kenya.20 A longitudinal study of a sample of children in Chile concluded that providing nutritional supplements to children to prevent malnutrition would generate benefits equal to six to eight times the cost of the intervention in terms of additional productivity.21 Health has been shown to be an important input into EG at the aggregate level as well.22

Education and health alone, of course, cannot transform an economy. The quantity and quality of investment, domestic and foreign, together with the overall policy environment, form other important determinants to economic performance. But the level of human development has a bearing on these factors too.

As in Chain A, the strength of the various links in Chain B varies considerably and there is no automatic connection between an improved level of HD and increases in per capita GNP. It is not enough to create a larger pool of educated people; there must also exist opportunities for them to be productively employed, or this might simply increase the number of educated unemployed. Relevant
to the demand side are the savings and investment rates, technology choices and the overall policy setting.

### III. EMPIRICAL FINDINGS ON THE LINKS IN THE CHAINS

In previous work, we have empirically explored some of the relationships in the two chains, using data from 69 developing countries applying OLS methods, though for some variables we have a smaller number of observations because of lack of data. Because of the two-way causation, we used lags of the original variables to reduce the simultaneity bias.

For Chain A, the variable chosen to measure human-development progress was Infant Mortality Shortfall Reduction (IMSR), 1960-2001. This was selected because the infant mortality rate is relatively accurately measured and is also highly correlated with other indicators, such as adult literacy and life expectancy. GDP per capita growth showed a significant positive relationship with IMSR, with higher growth of per capita income leading to better HD performance. We also found HD progress was significantly negatively associated with poverty levels and a measure of income inequality (the Gini coefficient), as well as positively with the gross primary female enrollment rate, and with public expenditure on both health and education as a percent of GNP.

For Chain B, the variable chosen to measure EG was GDP per capita growth, 1960-2001. We found that EG was significantly associated with various measures of HD progress, including the level of literacy, literacy shortfall reduction, the level of life expectancy and life expectancy shortfall reduction. We also found that EG was significantly associated with gross domestic investment as a percent of GDP.

In short, these findings confirmed the importance of the two-way connection between HD and EG and of many of the links in the two chains considered above. They also indicated that one can achieve good results in a variety of ways by relying on the strength of particular links in the chains. For example, a country can achieve good HD progress by high growth in the face of only moderately good income distribution so long as social expenditure ratios are high, as was the
case in Malaysia. Other countries have attained good HD progress with poor growth and poor distribution, but with high social expenditure and high female enrollment rates (e.g., Jamaica). In fact every country that was successful in HD seems to have had high female/male enrollment ratios and relatively high social allocation ratios.

IV. VIRTUOUS AND VICIOUS CYCLES AND LOPSIDED DEVELOPMENT

The existence of two chains linking HD and EG is thus strongly supported both by our framework, drawing on micro and macro studies in the literature, and our own empirical results. This means that an economy may be on a mutually reinforcing upward spiral, with high levels of HD leading to high EG and high EG in turn further promoting HD. Conversely, weak HD may result in low EG and consequently poor progress towards HD improvement. The strength of the links in the two chains influences the extent of mutual reinforcement between HD and EG in either direction, i.e., positively or negatively.

Consequently, country performance can be usefully classified into four categories: virtuous, vicious and two types of lopsidedness, i.e., lopsided with relatively strong HD/weak EG (called “HD-lopsided”) and lopsided with relatively weak HD/strong EG (“EG-lopsided”). In the virtuous cycle case, good HD enhances EG, which in turn promotes HD, and so on. In the vicious cycle case, poor performance on HD tends to lead to poor EG performance which in turn depresses HD achievements, and so on. The stronger the linkages in the two chains described above the more pronounced the cycle of EG and HD, either in a positive or dampening direction.

Where linkages are weak, cases of lopsided development may occur. On the one hand, good EG may not bring about good HD if, for example, there are such weak linkages as a low social allocation ratio; on the other hand, good HD performance may not generate good EG if there is a dearth of complementary resources because of low investment rates. Such cases of lopsided development are unlikely to persist. Either the weak partner in the cycle eventually acts as a brake on the
other partner, leading to a vicious cycle case or, if the linkages are strengthened, possibly by policy change, a virtuous cycle may result.

One way of classifying countries into the four categories is to compare their performance on HD and EG (1960-2001) with the average performance of all developing countries (see Figure 2). The vertical and horizontal grid lines represent the average performance for all developing countries for the period, with countries weighted by their populations in 2001. Most developing countries appear as either virtuous (NE quadrant) or vicious (SW quadrant); a significant number show an HD-lopsided pattern and only one an EG-lopsided one. A strong regional pattern emerges, with East Asia heavily represented in the virtuous cycle case. The majority of countries in the vicious cycle quadrant are from sub-Saharan Africa, with a significant number from Latin America as well. Latin America is also strongly represented in the HD-lopsided quadrant, with the one EG-lopsided country from Africa.

The important issue for policy purposes, of course, is how a country may move towards the virtuous cycle. Much can be learned about this by looking at the ways in which countries changed their location over time. Taking the movements of countries over the four decades
between 1960 and 2001, we find that only five countries succeeded in moving from the HD-lopsided to the virtuous category, while three remained in the virtuous category throughout. The others in that quadrant moved in and out of the HD-lopsided category, often in response to particular short-term economic difficulties, such as the 1980s debt crisis, which affected many of the Latin American countries, and the 1997 East Asian financial crisis. There was a strong tendency for countries in the vicious cycle to remain there; only five exited, four into HD-lopsided and one into EG-lopsided. Lop-sidedness, as expected, proved generally unstable. In particular, no country remained in the EG-lopsided category. As noted, some countries succeeded in moving from the HD-lopsided category into the virtuous category, but no country succeeded in moving from EG-lopsided to virtuous. Almost invariably, EG-lopsided countries fell into the vicious category. These findings clearly have some strong implications for policy sequencing. They imply that it is not possible to reach the ideal of a virtuous cycle by first generating improved EG while neglecting HD, since any EG attained in this way will not be sustained.

V. CONCLUSIONS AND POLICY IMPLICATIONS
Our investigation into the determinants of HD progress and EG has clearly demonstrated the importance of the two-way relationship between them. The empirical work confirmed the existence of a number of links in the two chains—including income distribution, the social expenditure ratio and female education in Chain A, and the investment ratio in Chain B, in addition to the important inputs of EG and HD respectively. Moreover, we have found that even in the presence of some weak links in a chain it is possible to achieve good progress by particularly strong performance in other links.

However, our most important conclusion concerns sequencing. Because of the strong two-way relationship between EG and HD, one has to promote both to sustain progress in either. Economic growth, which is an important input into HD improvement, is itself not sus-
tainable without improvement in HD. The investigation of country changes over time has strong implications for the phasing of policies. Economic and social policy have tended to focus priority on getting the economic fundamentals “right” as a necessary precondition for economic growth, arguing that HD improvement must await such economic growth—for example, in the classic “Washington Consensus.” In sharp contrast, our findings contradict the view that HD improvement may be postponed until economic resource expansion makes it affordable. If HD improvement is postponed in this way, EG itself will not be sustained.

NOTES

1. This paper draws heavily on previous work by the authors and others: see Ranis, Stewart and Ramirez, 2000; Ranis and Stewart, 2000; Boozer, Ranis, Stewart and Suri, 2003.

2. See the UNDP’s Human Development Reports.

3. See e.g., ILO, 1977; Sen, 1984; Streeten et al., 1981; Fei, Ranis and Stewart, 1985.


7. Human Development Report 1996, p. 71. These calculations adopt a narrow definition of social priority expenditure, including pre-primary and first-level education plus primary health care only.

8. Riddell et al., 1995.


10. Lavy et al., 1995.

11. This does not detract from the intrinsic value of improving the lives of those who cannot find employment because of disabilities or age, for example.

12. See surveys in Behrman, 1990a, b, 1995; Behrman and Deolalikar, 1988; King and Hill, 1993; Psacharopolous, 1994; Schultz, 1988, 1993a, b; Strauss and Thomas, 1995.

14. Schultz, 1975; Welch, 1970; Rosenzweig, 1995; Foster and Rosenzweig, 1994; Behrman et al., 1995.


17. Psacharopolous et al., 1992, p. 48. De Gregorio and Lee, 1999, find that “higher attainment and more equal distribution of education . . . play a significant role in making income distribution more equal” (Abstract).


23. For the detailed regressions, see Boozer et al., 2004.

24. Lagged values are reasonable candidates as instruments since the correlation between the residuals in the two periods analyzed is not substantial.

25. Shortfall reduction is measured relative to ceiling levels of countries at current maximum achievement, i.e., 3/1000 for infant mortality and 85 years of age for life expectancy.

REFERENCES


Realizing Rights:
Challenges for the International Forum for Development

Mary Robinson

The International Forum for Development has the potential to serve as a think tank and catalyst for fostering viable alternatives to mainstream trade and development strategies which will ensure greater social equity and which will draw more extensively on the experience and knowledge of countries and experts from the global South. IFD’s annual meeting is one important vehicle for highlighting this work to key policymakers and advocacy organizations and for building new alliances for change.

I am particularly pleased that our first annual conference included a public session open to interested individuals, groups and organizations concerned with social justice and equitable development as well as a number of smaller panel discussions which will bring together UN delegates and civil society organizations to address themes of particular concern to the NGO and civil society community. It is that connection—between the best academic research and policy alternatives, policymakers in government and civil society actors—that is missing today and which prevents necessary reforms in so many cases.

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I thought that Harold Koh, assistant secretary of state for human rights under President Clinton and currently dean of the Yale Law School, summed up this dilemma brilliantly in an article last year for the *Stanford Law Review*, and I quote:

My time in government confirmed what I had suspected as a professor, that too often, in the world of policymaking, those with ideas have no influence, while those with influence have no ideas. Decision makers react to crises, often without any theory of what they are trying to accomplish, and without time to consult academic literature, which, even when consulted, turns out to be so abstract and impenetrable that it cannot be applied to the problem at hand. On the other hand, activists too often agitate without a clear strategy regarding what pressure points they are trying to push or why they are trying to push them. Scholars have ideas, but often lack practical understanding of how to make them useful to either decision makers or activists . . . Like so many aspects of international relations, this phenomenon has generated a tragic triangle: Decision makers promote policy without theory; activists implement tactics without strategy; and scholars generate ideas without influence.

The IFD hopes to address this “tragic triangle” by involving intellectuals, political leaders, journalists, business leaders, NGOs and organized labor movements from the global South and North in an effort to identify the ways in which the forces of globalization can be harnessed to promote greater social equity and to work to find viable alternatives to current mainstream economic policies, which clearly haven’t worked for many developing countries.

Allow me to offer a few thoughts on what I see as some of the key challenges ahead for the IFD.

First, speaking from the perspective of someone who spent a career mainly in government service but also in academia and closely involved with civil society activists, I believe a key challenge the IFD will face is how to ensure broader dissemination and communication of policy alternatives on a range of issues—from agriculture trade policy to health systems to financing for development—which challenge mainstream thinking.

Civil society activists will point out that to influence policy debates nationally or internationally, policy alternatives must be
“translatable” into clearly articulated, non-technical messages that can easily be grasped by a wide range of audiences, including such political officials as parliamentarians, ministers and officials in key agencies, as well as journalists, organizers and other opinion makers. So there is a clear “communications challenge” that we will need to address.

A second challenge for the IFD is that civil society actors will demand that any proposed policy reforms be consistent with international commitments to human rights, labor and environmental standards. I am aware that many economists and development practitioners are still wary of incorporating such concerns more directly in their analysis and activities. Allow me to reflect on this issue briefly from the perspective of human rights.

Three principal criticisms of the human rights approach are commonly made by those who work in the field of development.

First, development experts often feel that human rights are “political,” by which they mean that they are overly focused on the state and use adversarial and judgmental techniques to monitor state performance that politicize the development process unhelpfully. Connected to this is the complex issue of sovereignty. They argue that, by appealing to international standards, human rights advocates diminish the notion of national sovereignty, irritating national governments and undermining efforts to make them nationally responsible. Without local ownership, critics say, development cannot be achieved.

This claim is worth a more extended discussion than can be had here, but allow me three short remarks. The first is that the human rights framework does focus first and foremost on the responsibilities of states, and it does indeed have an adversarial critical tradition. At the same time, more human rights organizations now also work with states on issues of reform, and in doing so they come closer to the methodologies and programs of development agencies. Human rights organizations are broadening their work to address other actors too, notably business, and this trend can also be observed at every level—international, national, in civil society and so forth.

The second point concerns the issue of sovereignty. The human rights approach does put the state at the center of responsibility. This
means that human rights advocates consider national governments, and national societies, to be the key locus of action. But it is a misunderstanding to conclude that, because the human rights system draws legitimacy from international standards, it is essentially interested only in the international dimension. The importance of international standards is that they establish an agreed objective, a minimum—rarely a maximum—standard, to ensure that all people are protected in key areas of their lives. There is a benchmark, in other words, for states to attain—but this is not the end goal. The end goal is the creation of a government and a society (and in our existing legal order that means national government) that protects rights because both governments and members of society are adequately accountable.

My third observation is to note that the issue of sovereignty presents itself just as acutely in the work of development agencies. Not surprisingly, in a world of highly unequal nation-states, it is not easy to escape. Development agencies are regularly accused of promoting policies that reflect their cultural traditions or serve their national interests at the expense of smaller and poorer states. They are also often accused of failing to address questions of abuse, because they are politically sensitive, even though they undermine the credibility of their development strategies. The merit of the human rights framework in this respect is that it makes judgments on performance in relation to objective standards that have been agreed upon by the international community as a whole—including, in most cases, the government in question. As a result, the case for arbitrariness and bias or abuse of unequal power is that much more difficult to make.

A second criticism is that human rights advocates overstate the importance of law and presume the state has a capacity that it often does not have. They are accused of failing to take proper account of underlying social and cultural causes of underdevelopment and failing to understand that development is necessarily a long-term process, extending over several generations. They are accused of ignoring the fact that successful reform processes must cope with numerous failures and political backsliding.
To some extent, I think this used to be a fair criticism; however, the situation has been changing rapidly. Many human rights organizations now recognize the need to go beyond “naming and shaming” alone. They are engaging with government reform processes and working out how to cooperate with government while retaining their critical independence. Their thinking is evolving and they are gaining experience.

The movement is not all one way, of course. Development specialists—from the World Bank outwards—are today much more conscious of the importance of governance than they used to be. The link between transparency, accountability and political inclusion—all values central to human rights—is very widely recognized, as is the frequently devastating impact on development of corrupt and oppressive rule.

The third criticism I hear most often is a rather specific one. It is usually made by economists who say that human rights advocates appeal to high principle but cannot apply themselves to practical decision making. A critic of this sort claims that economists and administrators must regularly choose one “good” outcome at the expense of another because there is not enough money to go around; accepting such “real world” constraints, they rationalize their decisions as responsibly as they can. By contrast, it is argued, human rights advocates are not only unable to use their principles to choose between two “goods,” they refuse to do so or to acknowledge the real constraints of scarcity, but say minimum standards must be met immediately, across the board. In this respect, the critic goes on, human rights advocates are irresponsible: they claim too much, they refuse to trade, they will not address the problem of resource limits—in short, they are all norms and no teeth.

This criticism also deserves a more extended answer than I can give here. In fact, I agree that human rights advocates often find it difficult to trade—to negotiate, to do deals—but believe this is not (or is not necessarily) because they are unrealistic or “other worldly” in their thinking. The human rights framework is systemic. Its ambitious aim has been to develop a body of principles that, taken together, provide points of reference for all cases where issues of rights arise. It is
the systemic nature of human rights which explains why advocates of rights often speak of their universality and indivisibility. This is not jargon—it highlights the belief that respect for any right cannot be achieved in the absence of respect for other rights.

As a result, however, rights advocates find it difficult to bargain—to set aside protection of one right in favor of protecting another. Unlike development, human rights work is not a pragmatic tradition. And since human rights advocates are often unfamiliar with other traditions—just as other traditions are unfamiliar with the systemic nature of human rights thinking—difficulties of communication are almost inevitable.

I do not accept that the human rights approach is inherently unrealistic. First of all, the human rights standards do take account of resource constraints and were drafted in a quite practical spirit—governments would not have consented to them otherwise. To illustrate, I would point to the increasingly skillful way those working for child rights are analyzing national budgets to see whether the allocation for education is being progressively implemented, or whether there is new expenditure, for example, on unnecessary military equipment.

Secondly, I believe that a lot of good work is now being done that in time will enable decision makers to draw upon human rights standards in ways that will help to improve the transparency and accountability and quality of their decisions. I do not say that all decisions will be assisted by referring to human rights; but many could be. Taking account of human rights obligations will often suggest indicators that can assist decision making; and evaluating decisions against human rights criteria will often assist decision makers in identifying where their policies are likely to produce, or have produced, discriminatory outcomes or outcomes that are otherwise undesirable.

Finally, concerning the claim that human rights are “too normative,” it is true that the human rights system is based on norms, on values. In my view, so it should be. My comment is really that other systems are as well. Let me again be a little provocative and suggest that classical economics is open to a very similar charge. Its notion of economic man (economic woman?) postulates a norm of human
behavior that is highly unrealistic, though useful. I do not believe for one moment (and nor do most economists) that most human beings act in practice in ways that maximize their economic advantage. Altruistic behavior is commonplace, as indeed are financial incompetence and simple lack of interest in economic matters. In this respect, the human rights framework is not a uniquely normative approach and its strengths and weaknesses should not be judged as if it was.

So to sum up this reflection: Let us be clear in assuring all the economists and non-lawyers here that I don’t believe human rights provide all the answers to addressing today’s development challenges. But what this framework does provide is a set of moral claims and internationally agreed-upon legal obligations and mechanisms which can and should be looked to more proactively by economists and development practitioners in efforts to steer the path of globalization in a way that is more accountable, more participatory and more beneficial for all people. Why? Because it will help shift the focus of analysis to the most deprived and excluded, especially to deprivations caused by discrimination. It will permit policymakers and observers to identify those who do not benefit from development. This is extremely important because so many development programs have caused misery and impoverishment inadvertently or out of sight, because planners only looked for macro-scale outcomes and did not consider the consequences for particular communities or groups of people. The ability of human rights to force attention towards those who lose out is a specific contribution this framework can make to policy making and development planning.

It won’t be an easy task to build bridges of understanding between economists and lawyers, but I would encourage the IFD to involve human rights experts and advocates even more in your work as it develops. At the end of the day, human rights principles are meant to represent the highest values in the international system. They could be seen as the ultimate end goals of all policy making nationally and internationally.

One final challenge for the IFD that I would encourage us all to reflect on is how we can most effectively influence current initiatives and policy debates from the outside and the inside. There are two ini-
tiatives we at the Ethical Globalization Initiative are involved with which I would like to mention in this context.

The first is the Helsinki Process on Globalization and Democracy, an initiative led by the foreign ministers of Finland and Tanzania. This partnership is now expanding to include a diverse group of like-minded countries from North and South. The Helsinki Process seeks new approaches to solving global problems. We seek to build an alliance for change in global decision making which is fair, safe, viable and democratic. Those of us participating on the Helsinki Group see as our mission to make the international community more democratically accountable in setting global policies and, secondly, more coherent and more compliant in implementing globally agreed-upon policies, such as human rights and the UN Millennium Goals on poverty and human security.

The greatest challenge is to move from “what needs to be done” to “how to do it,” from efforts to results. These proposals for “how to do it” are currently being developed and will be introduced in the Helsinki Process report to be released in the summer of 2005. The challenge is to mobilize people and the actors of the international community behind concrete plans of action. The Helsinki Conference, in September 2005, will serve as a tool for mobilizing people and creating coalitions for implementing the reforms.

The second initiative I would like to mention is the Global Commission on International Migration. The public debate in most countries around migration has thus far been marked by negativity, hostility and fear of migrants. The international community has never developed effective rights protections for migrants. No international migration institution or mechanism frames or manages the rights of people who move between countries. At the national level, policies tend to focus overwhelmingly on the legal exclusion of unauthorized migrants. As population and poverty trends continue to further divide the world into stark divisions of overpopulated, young and poor states, on the one hand, and wealthy, aging and declining-population states, on the other, migratory pressures will only intensify, making the need for a policy framework to guide this phenomenon ever more urgent.
I am pleased to be a member of this commission which seeks to reframe in a more positive way the migration debate, to understand that the rights of people who have left their countries in search of greater human security must be protected and that governments—both sending and receiving—must be accountable.

The commission is currently developing policy recommendations which it will deliver to UN Secretary-General Kofi Annan before the end of 2005. We are focusing on what we are calling the “3Ds” of migration—democracy, development and demography.

I believe we are now at a crucial moment for both of these global initiatives. Both seek new approaches in addressing the failures of governance which we have seen over the past 10 years. Our collective challenge is to devise effective policies and advocacy campaigns which can influence the outcomes of these and other initiatives at every level. There is a real opportunity here for the IFD that should not be missed.

The future can be different. We can make globalization a more values-led and ethical process which benefits all people. Central to that challenge is finding new ways of making progress in realizing the fundamental rights of people in every part of the world.

I am convinced that the work of the International Forum for Development is a crucial part of making this change come about.
Part 2:
Growth and Employment
I. HISTORICAL BACKGROUND

It is somewhat paradoxical that market economies, even under the system of representative political democracy, can live with high unemployment, and place relatively little emphasis on this problem, except perhaps at times of elections. Various plausible explanations can be offered, and perhaps they all contain some elements of truth. After all, the deep change in the climate of economic management, in sharp contrast to the post-WWII years of policies in pursuit of full employment in advanced market economies, is unlikely to be the consequence of any single cause. As historical narratives often remind us, changes in history are seldom mono-causal; instead, they are usually the result of several factors and processes coinciding at a particular juncture of time.

The climate of opinion against the Keynesian style of demand management in pursuit of high employment advanced gradually for at least three interrelated reasons. First, the Keynesian argument was almost self-consciously set in the context of an economy closed to international trade and capital flows. The intention may well have
been to emphasize the importance of domestically oriented economic policies for fighting unemployment. After all, the disastrous consequences of “beggar-thy-neighbor” policies of trying to export unemployment through competitive devaluation of national currencies during the inter-war period was still fresh in memory, while the prestige of the “City of London” in propounding the virtues of “sound finance” was in ruins (Bhaduri and Steindl, 1985). It was rather natural in that context to look inward for a domestic solution to the problem of unemployment.

Secondly, although the contest between the competing systems of capitalism and socialism was most visible in the Cold War arms race, its ideological dimension was essentially economic. The socialist system appeared capable of providing full employment through deliberate state policies, although much of that employment was neither satisfactory to the employees nor socially gainful. (A common joke of the time in these countries was, “They pretend to pay, we pretend to work.”) In the capitalist market economies, the level of employment depended largely on the decision of private business, posing an opposite problem: Although the jobs it provided had to be gainful to the private employer, even if private and social gain differed, the level of economic activity was prone to cyclical fluctuations, at times resulting in severe and persistent unemployment. Given this known difference in the performance of the two systems, even such initiatives as the Marshall Plan tended to be influenced at least partly by the economic competition between the two systems (Hobsbawm, 1994). It was also around this time that the welfare state found wider political acceptance, with its theoretical rationale in Keynesian demand management policies. The rising real wage with near-full employment, leading to a rapidly improving standard of living for the working population under this new style of economic governance in most western democracies, could be posed as a counter-challenge to the socialist ideology.

Thirdly, the very success of demand management, high employment and rising mass consumption, which had ushered in a “golden age” of welfare capitalism through rapidly expanding domestic mar-
kets for nearly a quarter century, came to be troubled by its own con-
tradictions (Marglin and Schor, 1990). Years of high employment had
reduced the fear of job loss for the workers and increased workers’
wage claims. Against this background, the experiences of the two
major oil price increases of the 1970s made it clear that the burden of
such shocks could not be passed on easily to the workers. The model
of cooperative capitalism of the welfare state was giving away to the
model of conflictive capitalism, in which struggle over the distribu-
tion of income tended to manifest itself through inflationary or
stagflationary price rises (Rowthorn, 1977). Even more problemati-
cally, the fiscal policy of the state itself got entangled in this distribu-
tive conflict, as both the workers and their employers tended to pass
on the additional tax burden to one another (Bhaduri, 1986, Chapter
6). Understandably, targeting inflation rather than unemployment
became the new focus of policies. New economic doctrines, at times
reviving old ideas that had been pushed aside by the success of
Keynesian economic policies, returned in academic circles and policy
discussions under the broad heading of monetarism. Ironically, mon-
etarism revived the Marxian idea that a “reserve army of labor” is
needed to keep a check on the real wage. Kalecki (1943, reprinted in
1971) had already made use of a similar idea towards the end of the
Second World War to predict that “political trade cycles” would be
imposed deliberately, particularly in the name of sound finance (read:
no deficit financing), to inflict unemployment from time to time in
order to keep control over the workers. These ideas returned in the
orthodox monetarist framework as the “natural rate” of unemploy-
ment (Friedman, 1968) or as the non-accelerating inflation rate of
unemployment (NAIRU) (Layard, Nickell and Jackman, 1991). The
common theme held that keeping inflation and inflationary expecta-
tions under control requires accepting a certain, even fairly high, rate
of unemployment. In particular, it requires giving up demand man-
agement policies intended to keep the rate of unemployment lower
than that “natural” or NAIRU rate. Since deficit financing by the gov-
ernment had been the most potent instrument used for demand man-
agement, unsurprisingly it came under special attack. The doctrine of
“public choice” theory proclaimed the virtues of a balanced budget and the evils of a fiscal deficit by a self-seeking government, and held these as general truths applicable to almost all countries under all circumstances.

These theories and policy perspectives directed against the welfare state and Keynesian policies were embedded in the wider process of globalization that had been going on mostly through gradual expansion in postwar international trade. However, they gathered irresistible momentum with the deregulation of national capital markets, beginning in the mid-1970s in the OECD countries. The greater economic opening in the trade of goods and services meant an increase in the relative importance of the foreign or external market compared to the domestic or internal market. It encouraged countries to stimulate demand through export surplus, rather than through demand management by government fiscal policies. As a result, each country will try to be more price competitive than its neighbors by cutting unit cost through wage restraint and labor market flexibility, on the one hand, and by raising labor productivity, on the other. Yet there is an obvious “fallacy of composition” in this strategy: All countries cannot achieve export surplus at the same time, as the export surplus of some must be matched by the import surplus of others. Moreover, even for any particular country that does manage to achieve an export surplus in this international zero-sum game, such policies may turn out to be counter-productive if the contraction in the size of its internal market more than outweighs the expansion of its external market.

The danger of contraction of domestic demand from such policies is serious. Wage restraint depresses consumption by working people, while labor productivity growth brought about by corporations through downsizing of the labor force reinforces this depressive effect. The overall consequence might be a decrease in the size of the domestic market despite an increase in the external market through export surplus. Analytically, this may be identified as the wage- or consumption-led regime, in which wage restraint and downsizing have depressive effects that outweigh their possible stimulating effect on investment and export (Bhaduri and Marglin, 1990). Nevertheless,
this danger of a sharp decline in domestic demand tends to be over-
looked for reasons that have become almost the defining characteris-
tic of the current phase of globalization.

It is well known that the deregulation and liberalization of capital
markets since the mid-1970s has phenomenally increased the volume
of private trade in foreign exchange. With a daily volume of some
$1.2 trillion, such trade far exceeds the total foreign exchange reserves
of all the central banks put together. Foreign trade and investment
combined account for less than four percent of private trade in for-
eign exchange. Thus, in formulating their economic policies, nation-
al governments feel obliged to abide by the sentiment of the extreme-
ly powerful financial markets, particularly because finance can move
across borders at a moment's notice. Expansionary fiscal policies for
fighting unemployment through either deficit spending or imposing
higher taxes on the rich to expand government programs are gener-
ally not favored by the financial markets. In this context, tax cuts
remain almost the only option for stimulating demand, which might,
of course, cause larger budget deficits. Similarly, so-called “easy
money” policies, in which low interest rates aim to boost economic
activity, are often seen as suspect, as signals of the government’s inten-
tion to embark on expansionary policies which might, in turn, lead
to trade deficits or capital outflows.

The typical consequences of abiding by the sentiments of the
financial market have been oversensitivity to inflation, insistence on
the independence of the central bank and a near-paralysis of fiscal and
monetary policies. Variations on this policy package are found in some
developing countries, but also in developed countries. They tend to
deliberately keep the domestic interest rate high for attracting short-
term capital inflows, even if it discourages investment at home. Note
the general point that all such policies have the same economic con-
sequence of reducing the relative importance of the domestic com-
pared to the external market.

Multinationals tend to erode further the space left for national
economic policies. Governments in developed economies tread soft-
ly as far as taxing corporate profits is concerned. Not only are foot-
loose corporations capable of shifting to low-tax locations, but they can also make use of transfer pricing: outsourcing through various practices of intra-firm trade to show profit at more convenient points. And, although intra-firm trade, estimated conservatively at 40 percent of all manufacturing trade, appears as international trade, national governments have little control over it. Governments in developed countries try to deal with multinationals by forming supra-national arrangements about uniform taxes, competition policies, etc. However, among the developing countries, typically a “race to the bottom” takes place. As countries hope to improve their trade balance by becoming part of intra-firm trading networks, the link to such networks may indeed be the most tangible benefit of foreign direct investment, though the level of technology or skills transfer varies across country and sector and remains a topic of great controversy.

II. THEORIES AND COUNTER-THEORIES ON UNEMPLOYMENT
This alternative perspective, marked by its neglect of domestic demand and the domestic market, and which aspires to replace the Keynesian consensus, is neo-liberal in essence. Contrary to the Keynesian view that markets fail seriously—as when insufficient domestic demand inflicts serious unemployment—and thus need to be managed through public action, neo-liberalism emphasizes the opposite point of view. It wants to roll back government, on the assumption that the market by and large performs better than the state. The extreme view is to claim that markets never fail. Put differently, it is claimed that market outcomes with available information cannot be improved upon by government intervention, a view associated with the so-called “new classical” school of economic theory. A more moderate view is to suggest that the markets fail only because the price mechanism does not function properly at times, mainly due to incomplete information, e.g., information being asymmetrically distributed. This view, associated with various versions of “neo-Keynesianism,” leaves some room for government action through correcting the price mechanism. Nevertheless, insofar as unemployment is concerned, both schools share a common economic philoso-
phy that, in shorthand, may be described as the “neo-classical” view of unemployment. This view more or less rules the current academic and policy orthodoxy, and has three distinguishing characteristics contrary to the original Keynesian paradigm.

First, unlike Keynes and Kalecki, who identified the lack of effective demand in the market for goods and services as the central cause of unemployment, these theories look directly at the labor market to explain unemployment. Thus the causation runs directly from the labor market, and not indirectly from the product market, to unemployment. In terms of policy, this means demand management in the product market becomes less important than correcting the malfunctioning of the labor market.

Secondly, even the branch of neo-classical theory sympathetic to the Keynesian view (e.g., the neo-Keynesians), tends to make a distinction between the “short run,” when there may be insufficiency of demand in the product market, and the “long run,” when somehow the demand problem is resolved. This kind of dichotomy between the short and the long run is most starkly visible in nearly all versions of neo-classical long-run growth theory.

Thirdly, and perhaps most basic to this neo-classical way of thinking, is the philosophy of “methodological individualism.” It uses some procedure of optimization by the individual agent as the central organizing principle of macroeconomic theory. Approaching macroeconomic problems exclusively in this way has many serious ramifications, and, with regard to the unemployment problem, perhaps its most serious consequence is to blur the distinction between “voluntary” and “involuntary” unemployment. All unemployment, even mass unemployment, begins to look voluntary in this framework, because it has to be explained through some optimizing decision by the individual worker. The problem then becomes attributable to the imperfect functioning of the price mechanism for giving wrong signals to the unemployed worker. In some theories, government interventions, mostly related to the welfare state, are supposed to distort the signals carried by wages in the labor market. In this framework, either the jobless worker becomes responsible for his or her own situation or the
blame is put on government intervention. Needless to add, this serves well the neo-liberal case.

A basic attraction of this neo-liberal theory stems from the idea that the market has a very different kind of advantage over the government. It is not mentioned explicitly, but follows from the present body of theoretical knowledge on the subject: Even under the most idealized circumstances of perfect competition—when the competitive equilibrium has all the desirable properties of Pareto optimality by the so-called “fundamental theorem” of welfare economics—nothing in economic theory specifies *how long it might take to reach that equilibrium*. This ambiguity helps in sustaining the market ideology. In democracies, the government and the politicians in power remain accountable to their people at regular time intervals through elections, but the market mechanism has no such definite time horizon for showing results. It can always be claimed that, given “sufficient” time and “sufficiently” wide-ranging pro-market reforms, the desired results would materialize, without having to specify how long is sufficiently long. In this respect, the market mechanism, like a dictator, can always promise without actually delivering.

The enormous power wielded by the electronic media and television images in shaping public opinion was noticed even in the very early stages of globalization by perceptive commentators (e.g., McLuhan, 1960). In particular, it helps in spreading a sort of popular culture of economic policy, which is the lowest common denominator of economic theory, and can be easily comprehended by men and women of “practical affairs.” In this respect, easiest to comprehend is the analogy of the individual. Since spending beyond one’s means is bad, a government budget deficit is considered bad; since the demand for apples can be raised by lowering their price, the demand for labor can also be raised by lowering the wage rate; since hard work helps one to get ahead, so a corporate manager helps the economy to get ahead by downsizing its labor force. Underlying all of these popular pronouncements in the media is the neo-liberal foundation of methodological individualism. Unfortunately, even politicians who know better often feel helpless,
because political expediency demands that they do not swim against the popular current.

This popular culture of viewing macroeconomic policies exclusively through the lens of methodological individualism goes against the very logic of Keynesian-style demand management, which followed from a demonstration of the misleading nature of the analogy of the individual. The macro-economy is characterized by a circular flow of expenditure and income in which, unlike in the case of the individual, expenditure (i.e., demand) may determine income and output in situations of serious unemployment.

III. THE BASICS OF POLICIES FOR HIGH EMPLOYMENT

It is against this intellectual background that we need to reconsider policies for attaining and sustaining higher employment in developing countries. At the outset, it is worth pointing out that many different types of projects may be devised for generating employment. By and large, these projects would be country-specific, dependent on geography, stage of development, degree of openness, etc. The purpose of macroeconomic theory in this context is not to list a set of such projects irrespective of their country-specificity, but to indicate how to devise a program for generating and sustaining high employment in developing countries.

The preceding discussion already pointed out that the responsibility of maintaining high employment has gradually passed from the government to the market. This view is reinforced further in developing countries in two ways. First, the “less government-more market” economic philosophy propounded generally by the Bretton Woods institutions operates with full force through “conditionalities” imposed on developing countries experiencing balance-of-payments difficulties. Second, it is further reinforced by the governments in developing countries themselves, insofar as they often find it politically expedient to escape accountability by attributing the problem to the market and to the Bretton Woods institutions. The result is a set of “market-friendly” policies for employment generation that may or may not produce the desired results in any given time horizon. In
either case, the market cannot be held responsible for delivering within a given time period.

In the context of the unemployment problem, the most important feature of market-friendly policies has been to look upon wage simply as the major element of production cost for private employers, and not as an important factor in determining the size of the total domestic market. The result is to focus exclusively on the labor market instead of paying sufficient attention to the fact that no cost-cutting measure can succeed in isolation without sufficient demand. The various measures that are undertaken—wage restraint, downsizing of the labor force, change in labor laws that makes it easier to hire and fire employees, revision of pension fund laws in favor of the employer, curbing workers’ rights to strike, etc.—are like designing a more and more efficient privately owned boat without enough water or demand in the public river for it to float.

The dependence on the private sector to solve the employment problem is also a slippery path, especially in the context of globalization. The more a developing economy tries to integrate with the world market, the stronger the pressure becomes for reducing unit cost through the labor market for achieving international competitiveness, or for attracting foreign direct investment and other forms of capital flows. This dependence impacts employment policies adversely in two different ways.

First, labor productivity growth that makes more goods and services available for domestic use is not pursued as a desirable objective in and of itself; instead, its desirability is judged in terms of enhancing international competitiveness. Note also that more goods and services would be available in the aggregate from higher productivity only if higher productivity does not quantitatively outweigh a decrease in employment, whereas unit cost would decrease and enhance competitiveness so long as productivity per worker rises irrespective of the level of employment. Thus, the exclusive focus on competitiveness separates the employment objective from the productivity objective, making, for example, the downsizing of the labor force attractive in terms of unit cost but not necessarily in terms of
either aggregate supply or demand. Moreover, if demand fails to expand sufficiently fast to absorb both productivity and labor force growth, the result would be growing unemployment and various scenarios of jobless growth.

Second, the preoccupation with cost reduction leads to a focus on micro-efficiency at the level of the enterprise, but downplays macro-inefficiencies that result, such as serious unemployment due to insufficient demand. This has led to a blurring of the distinction between good management of an enterprise or household and sensible management of the economy as a whole. The former usually takes the market size for a product as broadly given (with some product differentiation, related new products, etc.) by the income of the actual and potential customers. The typical objective of any particular enterprise is to increase market share rather than the total market size through competitive micro-efficiency, whereas it is precisely the purpose of macro-management to ensure that the overall market size expands at a sufficient pace to absorb both the growth in the labor force and its productivity. There are, however, two rather special circumstances in which this enterprise management view might succeed: either by stimulating exports or by raising private investment sufficiently through these micro-incentives of cutting costs.

In the former case, the micro-efficiency paradigm could increase the international market share of the country concerned in a successful scenario of export-led growth. But it must be remembered that this is an international zero-sum game, and there must be winners as well as losers in this game. It cannot help all developing countries, especially the most disadvantaged among them that suffer from acute technological backwardness, limited diversification of exports, etc. In the latter case, the micro-efficiency paradigm might stimulate sufficiently the profitability of private investment to expand demand, and therefore the size of the market, through the multiplier in a scenario of investment-led growth (Bhaduri and Marglin, 1990). Note, however, that in both these cases the central point is that micro-efficiency in cost reduction has to result in sufficient expansion of macro-demand. The frequently made policy mistake is to think that this is an automatic outcome.
The pitfalls in this process are indeed many. For instance, exports not only need to expand but must exceed imports sufficiently to produce the necessary export surplus, otherwise demand would not expand sufficiently. Therefore, this strategy can work only for those countries that can achieve a sufficient export surplus while other countries with corresponding import surplus depressing their demand would face a serious problem. For this reason, trying to promote exports with very high levels of imported content typically fails in many developing countries.

There is no certainty either that private investment on a macro scale would be sufficiently stimulated through micro-efficiency at the enterprise level. Private investment in fixed capital needs to take a long view of the prospects for profit. Therefore, it tends to respond sluggishly in general to an increase in current profitability. More important, however, is an inherent coordination problem. Unless many firms become simultaneously convinced that their profit prospect has increased over a relatively long time horizon, aggregate demand will not increase sufficiently through private investments. On the other hand, each individual firm will hesitate to move first so long as other firms remain passive in their investment demands. Thus, relying exclusively on micro-efficiency at the enterprise level to solve the unemployment problem becomes fraught with many difficulties. In general, the more severe the problem of unemployment is the more difficult becomes the problem of coordination and of convincing private investors that the climate for investment has indeed improved.

Given these difficulties, perhaps the most obvious starting point for breaking the inertia of low employment is through the budgetary policy of the government. Current orthodoxy in economic theory, greatly helped by the Bretton Woods institutions in the developing countries, takes the view that budget deficits are undesirable in general and insists that the fiscal deficit of the government, estimated with or without interest payments on outstanding public debt, must not exceed a certain percentage of the GDP. There are two common objections against running large deficits. The first stems from the burden of serv-
icing this debt, the second from repeated recourse to large deficit as a “soft option” by an irresponsible government with dangers of inflation.

The first objection has greater force if the debt is external and needs to be serviced in foreign exchange by a developing country. A high level of external debt squeezes import capacity, and carries in addition the danger of precipitating a financial crisis if for some reason foreign lenders try to withdraw their credit in a panic. However, with internal debt these objections are less serious and often invalid. When an economy is growing and the government remains credible, there is no obvious limit to the extent a government can borrow further to service its debt. It is rather one-sided to suggest that only the level of borrowing, and no other indicator, like growth or employment level, affects the credibility of the government. Thus, in the face of serious unemployment, the central issue should not be whether the government should run a large deficit to finance its employment generating strategies, but whether such a strategy would be effective and sustainable. Three conclusions regarding the government’s budgetary policy follow: (1) more caution should be applied in contracting foreign debt and premature capital account convertibility, (2) a bureaucratic limit on the extent of the permitted budget deficit is no solution and (3) close examination is needed not of the deficit but of whether the deficit can be effective in fighting unemployment and sustaining a high level of employment with growth.

The second objection, about government budget deficit as a dangerous soft option, is mostly ideological. It follows from a general mistrust of the government, which is often, but not always, justified. The government, like the market, often fails, and fails miserably. The way to approach this issue is to consider whether some correction mechanism would be in place in case of serious and continuous failures by either institution. As already pointed out, the market mechanism is not self-correcting in the sense of being “close” to equilibrium within any given time horizon, nor does it have any in-built mechanism to correct income distribution or promote development and high employment. Thus, it might be ration-
al to accept a solution that improves upon what the market might attain within some given timeframe.

However, it must also be remembered that the experiences of bureaucratic central planning showed how disastrously things could go with no self-correcting mechanism in place. This is especially true without the economic accountability of the government in the absence of political democracy. In the light of experience, a pragmatic compromise between these two most essential institutions, the state and the market, seems unavoidable.

A more balanced approach that adopts a less ideologically colored position would be to let both these essential institutions develop in a historical “double movement” (Polyani, 1944). In this process, each would have to restrain the other from becoming over-dominating. By and large, this seems to have happened in most cases of successful development of the market economies. Employment policies, like any others, need to be devised without upsetting this dynamic balance. Thus, when the market visibly fails to cope, as in the case of serious unemployment, the state has to initiate actions and not leave matters to market incentives. Conversely, when the state over-reaches and tries to create socially unproductive employment in an unsustainable manner, the market has to reassert its ability to restore the balance. There is clearly no once-and-for-all answer in this complex game of balancing that is valid under all circumstances. It is more correct to view this process as a “challenge-and-response” situation between these two major and equally essential institutions.

Both for employment creation and for longer-run growth, it must be remembered that the notion of a resource constraint for the economy as a whole is different from that of the financial budget constraint facing an individual unit. With serious unemployment, excess capacity and inventories, the economy is not constrained by finance, but by how well it can make use of these underutilized resources. In these situations, it makes little sense to restrain the government from deficit financing by some inflexible rule in the name of “sound finance.” It also seems rather beside the point to talk of the “independence” of the central bank to follow a tight money
policy. It would be far better instead to start from the real economy and arrive at more flexible monetary and financial policies and rules. The mistake of monetarism has typically been to start the other way around.

In particular, if excess capacity exists in the relevant domestic capital goods industries with unemployment, useful economic and social infrastructural investments can be undertaken through budgetary or financial support from the government. It is not wise to wait for domestic or foreign private investment to solve the problem of growing unemployment or deepening recession, because the more persistent and serious the problem, the more difficult it becomes to turn around private expectations. As a matter of fact, in many developing countries public investment would act as a catalyst to “crowd in” rather than “crowd out” private investment, first by increasing the size of the domestic market and second by providing better infrastructural facilities to raise profitability. Needless to add, the impact of these investments on employment would be positive, and stronger if some of its construction components can be made labor intensive.

Nevertheless, the fundamental Keynesian insight that higher expenditure by the government would activate underutilized resources to generate more income and saving to finance the higher level of government spending has to be applied with some caution to suit the conditions of particular countries. So long as basic wage-goods are not in crippingly short supply or, as a second-best option, can be imported, identifying the broad direction for starting a public investment program is easier. Widespread poverty, or at least concentrated pockets of poverty, presents an opportunity for policymakers to devise useful public works through guaranteed employment schemes at some minimum wage for a certain number of days per year. The minimum wage would have a degree of self-selection to attract mostly the poor and needy.

However, despite some self-selection, these schemes tend to be wasteful in different ways. Policy packages that are often chosen by a remote, non-accountable bureaucracy frequently turn out to be useless because they fail to be sensitive to local needs. Very often, they also
suffer from “giantism,” i.e., unnecessarily big and technologically complicated projects that a centralized bureaucracy can handle more easily, but to which the unutilized and relatively unskilled labor cannot contribute effectively. A large percentage of the funds also tend to leak out in administering these public works, with the result that only a small fraction usually reaches the needy poor for whom they are intended in the first place. On the other hand, a large machinery for supervision increases the leakage by raising administrative cost, but without it there is the danger of non-performance, inefficiencies and corruption.

The only way out of this dilemma is to take recourse to decentralization as far as possible with two added provisions. First, while the decentralized local bodies would have control over the use of the funds, there must be transparency of their budget through a legally recognized right to information, which has to cover both the central bureaucracy and the decentralized local bodies choosing and implementing the projects. The free availability of information naturally must apply both to the available funds and their disbursements. Second, to sustain such programs over time, attempts should be made to move increasingly towards the principle of “(s)he who benefits should (partially) pay.” This has to be based on two different pillars. The first is the pro-private sector policy. It would extend the schemes to specified types of capital formation on private property, chosen on the basis of their desirability by the local community and having some social benefits or positive externalities—e.g., small irrigation, land improvement, linked pathways through private land, etc. These would benefit directly one or more private owners, but also indirectly the larger community. They should also have the potential for sustaining employment at the local level, even when undertaken on private land or property.

The second pillar of this policy would be to ensure that the private owners who belong to the local community, and voluntarily participate to benefit directly, have to bear a part of the cost—e.g., in terms of paying part of the minimum wage bill or in paying a lump sum to the local body as capital gains on completion of the projects
(and when such payments would be to the local entities for their own use, they must be based on transparent rules). This would reduce both the cost to the local bodies and the need for supervision as the beneficiary himself or herself would be interested in the quality of the work done. In other words, it would be a way of subsidizing socially useful capital formation through private cooperation at the local level without losing sight of the employment objective. Within limits, the above argument may also be extended to the use of some social infrastructural facilities like secondary schools and vocational training centers, where the beneficiaries should bear part of the cost, which could be on a progressive scale decided by the local bodies.

It has often been suggested that better training schemes raise the aggregate level of employment. Experiments with various “voucher schemes” to determine the type of training demanded by the voucher-holders have been tried on a limited scale to make these schemes more responsive to individual needs and preferences by creating miniature local markets, in which the vouchers act as “votes” for choosing the particular training schemes. The schemes devised to mimic the market mechanism often turn out to be flawed, insofar as the schemes with maximum votes do not always turn out to be either very useful for the community or for getting jobs (Lepenies, 2004). The reason for the latter is that training facilities by themselves usually cannot generate more employment on the macro scale, because they are pure supply side policies. There must either be latent demand in the market for those skills, or conscious demand-side policies must complement them. Training either raises the bar on entry to the labor market or it becomes like shuffling the long queue for jobs, where the better trained are placed in the front without shortening the queue.

The connecting thread in this argument so far has been to point out the importance of domestic demand-led growth with adequate policy space for government action as the essential prerequisite for high employment policies in developing countries. Although larger-sized countries have the advantage of a larger domestic market, this perspective on policy is also useful for the smaller countries. However, large and small are rather relative terms in this context, especially
because the size of the market depends both on population and on per capita income. Therefore, regional cooperation, based on the guiding principle that the domestic policy space should not suffer, is to the advantage of all irrespective of size. This would be a feasible proposition only if democratic rights are observed. And, in the international context, the defining characteristic of any civilized democracy is the protection of minority rights, i.e., the right of the smaller or poorer nations, rather than the brute force of majority rule by the larger nations. The current process of globalization has generated discontent and disenchantment precisely because it has failed in this respect.

IV. CONCLUDING OBSERVATIONS

The basic elements of a policy for generating and sustaining high employment may now be summed up briefly:

- **A minimum-wage employment guarantee scheme.** This will kick-start programs in the face of serious unemployment, especially in rural areas.
- **Decentralization of activities and administration.** This should take place through local bodies with gradual extension to private properties based on the principle of “(s)he who benefits should (partially) pay.”
- **Transparency regarding the allocation and use of funds.** Ensuring this requires recognizing the right to information at all levels with respect to funds.
- **Domestic demand-led expansion.** This is the cornerstone of this strategy, which means placing due emphasis on the domestic market rather than being preoccupied with the external market. In this sense, it is not an export-led growth strategy because most developing countries cannot achieve an export surplus in an international zero-sum game. Nor is it an import substitution policy, because that too is motivated largely by considerations of the external market and foreign exchange.
Our emphasis instead is on changing the composition of investment to promote and sustain employment.

- *Ensuring that the objective of productivity growth is not separated from employment growth.* This separation typically happens if productivity growth is considered only as an instrument for enhancing competition or generating surplus. But it is forgotten that higher productivity along with higher employment makes more goods and services available for the domestic market.

- *An environment of sufficient growth.* Only a sufficiently expanding market can accommodate both labor productivity and labor force growth. While government policies can influence to some extent the rate of expansion of the market through its monetary and fiscal policies, it is important not to follow policies exclusively in search of productivity growth, since the latter makes sense only if productivity is considered a weapon for international competition. It is more important to recognize that, especially in poor countries with various types of technological backwardness and handicaps regarding international marketing, increased productivity is desirable to augment the availability of total output from the supply side, to be matched by an increased level of demand through higher employment.

- *Increase the social content of wages.* Decentralized public works leading to more economic and social overhead and infrastructural facilities help in increasing the social content of wage and earnings from self-employment, especially of the poor. Local bodies should try to ensure that this becomes a reality. This would help in reducing the need for an increase in private wages and make such employment-generating schemes more self-sustaining.

V. THE ROLE OF THE INFORMAL SECTOR IN EMPLOYMENT GENERATION: SOME OBSERVATIONS

Many developing countries are facing the serious problem of rapidly expanding cities and mega-cities with deteriorating infrastructure due to the massive influx of jobseekers in the urban sector. This has meant
more and more resources going to the cities in a desperate attempt to cope with the problems of urban infrastructure, with an attendant lack of resources being used to improve rural infrastructure. The result has been a steadily growing urban-rural divide and a phenomenal growth of the so-called informal sector. Thus, it is not only the direct pull of higher expected earnings in urban employment that leads to immigration into cities (Harris and Todaro, 1970) but also the indirect pull that operates, because the urban centers are generally far better equipped with economic and social overheads. This can be looked upon as the “social content” of wage or earning, and an objective of decentralized public works would be to reduce the gap in the social wage and earning.

Employment in the informal service sector has grown very rapidly in many developing countries. A high percentage of this employment is not wage employment but self-employment, and for these workers the separation of total earning between wage and profit income is rather meaningless. The entire self-employed category consists of a relatively small percentage of high-level professionals and, often, a very large percentage of the poor who take refuge in it part- or full-time both in the urban and in the rural sector, because they have no other opportunity for livelihood. In any employment policy, it is essential to consider this segment, with its typically massive, disguised underemployment. By and large, the productivity of these workers, at least in the short run, depends not so much on the capital equipment or skills they possess, but on the level and composition of demand and on the infrastructural facilities that they can use (Reddaway, 1962; ILO, 1972). One of the advantages of domestic demand-led policies, which would usually also involve improving local infrastructural facilities, especially in non-urban areas, is to be able to reach out to these people, who are often among the very poor.

For generating and sustaining employment in the informal, less-skilled services at a higher level of earning, several interrelated aspects need to be considered. First, and, in a way most obvious, is the emphasis on better irrigation and water management as well as communication. Apart from increasing the productivity and intensity of land use,
better water management allows crop diversification to absorb considerably more labor per hectare of land, and better communication is a prerequisite for the commercialization of agriculture, without which crop diversification cannot succeed. In countries that are not predominantly agricultural, or have natural limitations, conscious attempts have to be made to develop a symbiotic relationship between the organized and the unorganized sector through subcontracting, outsourcing, etc. For this relationship not to be exploitative, the government might have to use both regulations and incentives (e.g., tax breaks for such subcontracting to informal units). At the same time, independent artisan producers need design and marketing support, channeled as much as possible through decentralized local bodies receiving performance-related funds for this specific purpose from the government.

The way to visualize the strategic link between the general macroeconomic policies for domestic demand-led expansion and the informal sector is to develop the notion of “nodal points” of economic activities for employment generation. They would mostly have to work backwards from demand, somewhat like the “accelerator principle” in economic theory. In the past, policies in this respect often failed in many countries because more emphasis was laid on the supply side, without creating the necessary demand links, either from the local markets in the rural areas or from the organized industries or urban centers. The concept of a “node” might be a helpful starting point, insofar as various types of demand from these different sources would have to converge for the transformation of the informal sector from mostly a “refuse sector” of the poor and desperate jobseekers into a genuinely dynamic sector of the economy.

REFERENCES


The Impact on Advanced Economies of North-South Trade in Manufacturing and Services

Robert Rowthorn

In the past, North-South trade was based on supposedly natural differences. The rich countries exported manufactures and services in return for primary products from poorer countries in the form of food, minerals and raw materials. In fact, the term “natural” is something of a misnomer, since some of the poorer countries were prevented by administrative means from exporting manufactured goods or services to the rich countries, and their almost exclusive reliance on primary products was the outcome of history rather than nature.

In recent decades, a new kind of North-South trade has begun to emerge, driven by the abundance of cheap labor in the South. The production of many basic goods and services is being transferred from the high-wage economies of the North to the low-wage economies of the South, while the North is specializing in “knowledge-intensive” activities. Simultaneously, production processes are being fragmented so as to take advantage of international cost and quality differences. These developments first took off in the manufacturing sector but they are now spreading to services. More and more activities and countries are being drawn into what is already an extremely

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complex and dynamic division of labor. Moreover, patterns of trade are constantly changing as countries and firms move up the value hierarchy to more sophisticated activities.

These developments have caused unease in the established economies of the North where demands for protection from low-wage competition are commonplace. The U.S. presidential candidate Ross Perot campaigned against the North American Free Trade Agreement on the grounds that it would destroy American jobs: “If you hear a loud sucking sound, that is the sound of American jobs going to Mexico.” The U.S. Senate has recently passed a bill preventing the federal government from offshoring its activities to low-wage economies and there has been a similar move in many states. There are many websites demanding protection for American workers, including one with the title “www.yourjobisgoingtoIndia.com.” So far these demands have been resisted by the U.S. administration, and with George Bush as president there is unlikely to be any radical change in this issue. In Britain, the IT trade union, Amicus, has campaigned strongly against offshoring, although so far without much success. The minister for trade and industry, Patricia Hewitt, has explicitly rejected protectionism, arguing that the appropriate response to foreign competition is to do things better—or do something else.

This paper examines some of the issues raised by the new division of labor that is now emerging. It is primarily concerned with the rich economies of the North, in particular with the employment impact of trade with low-wage economies. In view of current protectionist sentiments in the North, this is an important topic. The paper begins by describing what has already happened in the manufacturing sector. This is followed by an examination of the rapidly growing North-South trade in services, in particular the development of “offshoring,” whereby service activities that were previously performed at home are transferred to other countries. The paper concludes with a brief case study which illustrates why competition with low-wage economies is a subject of legitimate concern in rich countries.
I. MANUFACTURING

The international division of labor in manufacturing involves trade between countries at many different levels of development. It also involves the exchange of both finished and intermediate products. International trade in intermediate products is increasing rapidly, especially in high-tech manufacturing where the global fragmentation of production processes is most advanced (Chart 1).

The effects on the North of manufacturing trade with low-wage economies are as follows. The importation of cheap goods, such as clothing, leads to job losses in the domestic industries that compete with these imports. However, the money which is spent on these imports returns eventually to the North in the form of export demand. Thus, exports from the North to the South increase. Some of these exports may consist of manufactured goods, such as sophisticated machinery, and some of services, such as banking or insurance. There are also indirect effects to consider. Because of cheap imports, clothing and similar items cost less than before, so that consumers have more money to spend on other things. Some of this money will be spent on extra manufactured goods and some on services, thereby generating additional employment for Northern workers. If the market mechanism functions smoothly,
there will be no overall change in Northern employment as a result of North-South trade. There will be fewer people employed in manufacturing but more in services. Moreover, per capita income will on average be higher because the North will have more goods and services at its disposal than before. This is the classic justification for free trade.

The above argument assumes that the market mechanism operates smoothly, such that workers displaced by competition from cheap imports are quickly redeployed elsewhere in the economy. In reality, the transition is rarely this smooth. Displaced workers may lack the skills required to occupy the new jobs available in other parts of the economy, or they may be located in the wrong part of the country, or wages may be inflexible so they remain unemployed. As a result, it may be some time before total employment recovers from the initial loss of jobs. There are also distributional issues to consider. The destruction of certain types of manufacturing employment through trade with low-wage economies, or structural change of any kind, means a shift in the skill and geographical composition of the demand for labor. Even if total employment in the economy as a whole is unaffected, certain localities and certain types of workers may be seriously harmed. For example, many localities in the advanced economies have never recovered from the effects of industrial collapse in the 1970s and 1980s. Many older workers who lost their jobs during this period have never worked again. Younger workers may have found new jobs in the service sector, but these are often inferior to the industrial jobs that were lost. The same is likely to be true of the changes now occurring because of cheap imports from the South. Large structural changes always produce many casualties, and dealing with their consequences may be far more difficult than is acknowledged by most advocates of free trade.

How important are the effects of North-South trade in practice? Manufactured imports from low-wage economies in the South have increased dramatically in recent years, but in monetary terms manufactured exports from the North to these countries
have also increased, though not as fast. As a result, there has been deterioration in the manufacturing trade balance of the North with the South. This can be seen clearly in Chart 2, which shows what has happened since 1962. In the late 1970s and early 1980s, following the rise in oil prices, there was a massive increase in manufactured exports from the North to the oil-producing countries of the South. To pay for oil during this period, the North required a large surplus in its manufacturing trade. With the collapse of oil prices in the mid-1980s, the manufacturing trade balance fell back sharply. There was then a period of stability followed by a renewed decline that has lasted until this day. In the case of Europe, the deterioration has been gradual, but in America the balance of manufacturing trade with developing countries has deteriorated dramatically in recent years.

Few would deny that the growth of North-South trade has affected the size and structure of Northern manufacturing industry. How large are these effects? Estimates reported in Rowthorn and Coutts (2004) suggest that, taking into account both direct and indirect effects, the OECD countries as a whole have lost around 9 million manufacturing jobs because of competition from Southern imports over the past 40 years. They have also gained around 1.5 mil-
lion manufacturing jobs through increased exports to the South. If we restrict our attention to the past decade, the imbalance between jobs created and destroyed in this sector is even more striking. Between 1992 and 2002, exports to the South created an extra 0.4 million manufacturing jobs. During the same period, imports from the South eliminated 5.4 million manufacturing jobs, giving a net loss of 5 million jobs in this sector. This is not a huge figure compared to total employment of 400 million, but the impact on particular types of workers or on certain localities has been much greater than such a comparison would suggest.

Chart 3 gives further information on the period 1992-2002. In the OECD as a whole, the share of manufacturing in total employment fell by 4 percentage points during this period. In the EU and Japan, about one quarter of the fall was due to North-South trade and the rest was due to other factors such as rapid productivity growth in manufacturing and shifts in the composition of demand away from manufacturing towards services. However, North-South trade was more important in the United States, where it accounted for almost half of the fall in the manufacturing share. This represents a net loss of roughly 2 million manufacturing jobs.
Such a loss reflects the surge of manufactured imports into the U.S. from China and other low-wage economies in recent years. This is a large number of jobs to lose in the space of a decade, especially given the weak overall demand for labor during the recession at the end of the period.

II. SERVICES

The importation of services from low-wage economies is nothing new. One of the attractions of vacations to poor countries is that they are cheap—although climate and other attributes are probably more important, as witnessed by the popularity of high-wage Australia as a tourist destination. What is new in the present situation is the rapid growth of international trade in services that were previously regarded as non-tradable. The main factor behind such a development is the revolution in information and communications technology, as exemplified by the Internet and the global telephone network. This is neatly expressed in the following quotation from a recent United Nations Conference on Trade and Development (UNCTAD) report:

Services typically need to be produced when and where they are consumed. In the past decade or so, advances in information and communications technologies have made it possible for more and more of these services to be produced in one location and consumed elsewhere—they have become tradable. The implication of this “tradability revolution” is that the production of entire service products (or parts therefore) can be distributed internationally—in locations offshore from firms’ home countries—in line with the comparative advantages of individual locations and the competitiveness-enhancing strategies of firms. This is well known in the manufacturing sector. (UNCTAD, 2004, p25)

The offshoring of services can be done in two ways: internally, through the establishment of foreign affiliates of the parent company, or by outsourcing to a third-party located abroad. The former is sometimes known as “captive offshoring” and the latter as “offshore outsourcing” (Table 1).
There are many different reasons why a firm may offshore some of its service production. The quality of service may be higher in another country or it may be rational to concentrate activities at a single location. For example, a computer helpline to serve a number of different countries may be located in a single place where there is a plentiful supply of people with the skills to handle enquiries. Another benefit may be reverse learning, whereby the offshoring firm may acquire capabilities that are later diffused throughout the global organization. These factors help to explain why a number of specialist services are offshored to high-wage countries such as Ireland and the Netherlands. They may also play a role in the offshoring of jobs to low-wage countries, but in such countries cost is likely to be the predominant factor. Bardhan and Kroll (2003) provide the following list of attributes that make a job ripe for offshoring to a developing country:

- no face-to-face customer-servicing requirement;
- high information content;
• work process is telecommutable and Internet enabled;
• high wage differential with similar occupation in destination country;
• low set-up barriers;
• low social networking requirement.

According to the information given in Table 2, the wage differential is greatest for comparatively unskilled occupations, such as telephone operator, and least for the highly skilled occupations, such as financial analyst. However, the term “unskilled” should be interpreted with caution in this context. The occupations concerned require literacy and numeracy and many require familiarity with a foreign language. Operations involving verbal communication, such as call center operator, are often classified as low-skill jobs in rich countries because they require linguistic knowledge and cultural familiarity that are widespread in the locality. In a developing country, however, the ability to speak a foreign language and to interact easily with foreigners is by no means universal. This may explain why call-center operators in India are university graduates. It is interesting that they earn so little as compared to professional workers. It may be that they have studied subjects that give them the skills required to communicate effectively with English-speaking foreigners but not those required to enter the more highly paid professions.

In geographical terms, North-South outsourcing has been dominated by English-speaking countries, such as Britain and the United States, and by countries that were previously in their formal and informal empires, such as India and the Philippines, where knowledge of English is fairly widespread. Over the longer term, economic forces will eventually draw all countries into the global network. Until now, North-South outsourcing has been concentrated mainly on less-skilled activities, such as call centers, basic data processing, basic programming and the like. However, countries or regions that have specialized in these activities are moving up the value hierarchy. This is partly because wages are rising and partly because they are acquiring new organizational and technical skills. Moving up the value hierar-
chy is a normal feature of development and is familiar in the manufacturing sector. Today’s exporters of sophisticated manufactured goods, such as Korea and Taiwan, began by exporting clothes, toys, basic household goods and the like. The same transition will inevitably occur in services. As wages rise in the exporting country or region, it becomes less economic to offshore basic services to such a location and the users go elsewhere to a place where wages are lower. This is relatively easy because set-up costs are comparatively low. Basic ICT-enabled services are footloose for the same reason that traditional light manufacturing is footloose.

<table>
<thead>
<tr>
<th>Occupation</th>
<th>Hourly Wage U.S.</th>
<th>Hourly Wage India</th>
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<tbody>
<tr>
<td>Telephone Operator</td>
<td>$12.57</td>
<td>Under $1.00</td>
</tr>
<tr>
<td>Health Record Technologists/</td>
<td>$13.17</td>
<td>$1.50-$2.00</td>
</tr>
<tr>
<td>Medical Transcriptionists</td>
<td></td>
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<tr>
<td>Payroll Clerk</td>
<td>$15.17</td>
<td>$1.50-$2.00</td>
</tr>
<tr>
<td>Legal Assistant/Paralegal</td>
<td>$17.86</td>
<td>$6.00-$8.00</td>
</tr>
<tr>
<td>Accountant</td>
<td>$23.35</td>
<td>$6.00-$15.00</td>
</tr>
<tr>
<td>Financial Researcher/Analyst</td>
<td>$33.00-$35.00</td>
<td>$6.00-$15.00</td>
</tr>
</tbody>
</table>

Source: Bardhan and Kroll (2003), p. 5

1. Threat to Jobs in the North
The effect of service offshoring on employment in the North has so far been small. Goldman Sachs estimates that 300,000 to 500,000 jobs have been lost in the U.S. because of service offshoring; that is a mere fraction of the estimated 2 million manufacturing jobs the country has lost in the past decade through competition with cheap imports from low-wage economies. As to the future, it is difficult to make firm predictions, although most analysts agree that the potential job losses are large.

The present debate on service offshoring was ignited by a report in 2002 by John McCarthy of Forrester Research in which he estimated
that 3.3 million American service jobs would move abroad by 2015. Since then, he has revised this estimate upwards slightly to 3.4 million (Table 3). According to the report, the following major occupational categories are at risk of losing jobs to offshoring: management; business and financial; computer and mathematical; life, physical and social science occupations; legal; arts, design, entertainment, sports and media; sales and related; and office and administrative support. In the United States, these account for approximately 56 million jobs or 40 percent of total employment. By implication, there is little or no risk of being offshored for the remaining occupational categories. Even among the at-risk groups, McCarthy believes that most jobs are safe for at least the foreseeable future. This is reflected in his estimate that 3.4 million American service jobs would move abroad by 2015. Tilton of Goldman Sachs considers this figure to be somewhat conservative and suggests that up to 6 million service jobs may be offshored from the U.S. over the next decade. Bhardan and Kroll (2004) also consider McCarthy to be on the conservative side, although they provide no estimate of their own. Instead, they list a number of occupations which they believe to be at risk of offshoring. The total number of people employed in these occupations is currently 14 million, although even on a worst case scenario many of these jobs would survive.

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<tbody>
<tr>
<td></td>
<td>300-500 thousand (Goldman Sachs)</td>
<td>Up to 6 million over 10 years (Goldman Sachs)</td>
<td>14.1 million (UC Berkeley)</td>
<td>136.9 million</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3.4 million over 13 years (Forrester Research)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.K.</td>
<td></td>
<td>750 thousand over 12 years (Forrester Research)</td>
<td></td>
<td>27.5 million</td>
</tr>
<tr>
<td>Rest of EU</td>
<td></td>
<td>400 thousand over 12 years (Forrester Research)</td>
<td></td>
<td>136.3 million</td>
</tr>
</tbody>
</table>

There are only a few estimates available for other countries. Andrew Parker of Forrester Research has investigated the prospects in a number of individual European countries. He estimates that 750,000 service jobs will be offshored from the U.K. and 400,000 from the rest of the EU over the twelve years up to 2015. As a proportion of total employment, the U.K. figure is similar to McCarthy’s estimate for the U.S. The figure for the rest of the EU is much lower both absolutely and relative to total employment. Parker ascribes the low EU figure to “management caution, tight employment legislation, trade union resistance, and the higher numbers of smaller companies with limited offshore scope.” Curiously, he does not mention language. It is hardly an accident that the trend towards service offshoring has been dominated by English-speaking countries, such as the U.K. and the U.S., which can link-up with a large network of educated English-speakers in developing countries. There are few countries in continental Europe that have such extensive international linkages in their native language.

It is difficult to know whether the above estimates are small or large. As a percentage of total employment or in comparison with the annual turnover of jobs, the pace of outsourcing looks fairly small. For example, the estimates of Forrester Research for the U.S. and the U.K. imply that the number of service jobs offshored by 2015 is equivalent to some 2.5 percent of total employment and 6 percent of employment in the broad occupational categories in question. These are similar in magnitude to the loss of manufacturing jobs over the past decade because of low-wage imports. They are a mere fraction of the huge structural shifts that have hit manufacturing industry over the past 30 years. Even so, for particular types of workers and particular locations, they could have serious implications.

2. An Example
To illustrate this point, consider the following example from Britain. Mainland Britain is conventionally divided into two geographical areas—Northern Britain and Southern Britain. The dividing line
between the two areas runs roughly from the River Severn to the Wash. Southern Britain comprises everywhere to the south of this line, including London. Northern Britain comprises the rest of the mainland, including Scotland and Wales. The economic structure of the two areas is different and their economic performance has been different. Although both areas have failing and successful parts, Southern Britain as a whole has been more dynamic than Northern Britain in recent decades. It has suffered less from the decline of industrial manufacturing and mining employment, and it has gained a disproportionate share of the new jobs in such dynamic areas as financial and business services. Northern Britain has gained service jobs, but many of these have been in the public sector financed by transfers from the central government. Growth in the private sector in this part of the country has been quite weak and unemployment is still very high among older workers and younger unskilled workers.

This is the background against which the present British debate about offshoring should be viewed. Some years ago, the government made a big and successful effort to attract contact centers (call centers, help desks, etc.) to Northern Britain to fill some of the gap left by the collapse of industrial employment. As a result, there are now 290,000 people directly employed as contact-center “agents” in Northern Britain, answering queries and approaching actual and potential customers. In addition, there are 160,000 others working in these centers in supervisory and ancillary occupations. This amounts to almost 3.7 percent of total employment in Northern Britain and 22 percent of employment in the area’s financial and business services. Since the original intention was to create employment for people with few formal qualifications, a majority of these jobs are in large call centers which handle routine enquiries, and formal qualifications are not very important (Chart 4). According to a recent government report (DTI 2003), such call centers are vulnerable to offshoring, and the expectation is that many of the jobs will move to cheaper locations abroad, such as India and the Philippines where wages are 10-15 percent of what a call-center agent receives in Britain. So far, the number of con-
Contact-center places offshored is small, but the potential is very large (Chart 5).

The DTI report projects that the number of people employed in contact centers in Britain as a whole will continue to increase, although at a slower rate than the past. However, given the potential for offshoring and even automation of the more basic tasks, this projection should be treated with caution. Even if total employment in contact centers does rise, the disappearance of the basic, large-scale centers would be a serious loss to the old industrial cities of Northern Britain where most of them are located. It is not surprising that there is concern in these communities about offshoring.

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**Chart 4**
Regional Location of Contact Centre Agents in Mainland Britain

**Chart 5**
Contact Centres: Number of Agent Positions
III. CONCLUDING REMARKS

The offshoring of service jobs poses a number of threats. The workers who lose their jobs, together with their families and localities, will suffer loss of income. So will those who have to compete with such laid-off workers or who must accept lower wages so as to prevent their jobs being offshored. This is what primarily motivates trade unions when they organize to prevent offshoring. However, the trade unions also use another argument to win public support and influence policymakers. Some of the service jobs already threatened by offshoring are relatively skilled, and the number of these jobs lost is likely to increase as countries like India develop and move up the value hierarchy. The unions argue that the loss of these jobs will weaken the economies of the North and eventually undermine their ability to compete with the emerging economies of Asia and elsewhere.

This is, of course, an old argument, which has appeared throughout history when established economies are challenged by rising commercial or industrial powers. It raises two distinct, although related issues. Success in international competition does not depend on absolute strength alone but also on the strength of one’s rivals. If the objective is to succeed in international competition, this can be done by preserving or increasing the absolute strength of one’s own economy or by inhibiting the development of rival economies. Such behavior is routine in commercial life. Indeed, as Karl Marx pointed out long ago, the struggle to create and undermine intellectual monopolies is the essence of competition in a knowledge-based economy. What goes for firms is also true, up to a point, for countries. The transfer of knowledge abroad may simultaneously weaken the sending country and strengthen recipient countries, thereby shifting the balance of competitive power at both ends. This is the kind of fear to which many of the opponents of offshoring appeal. Free traders typically dismiss such fears as unfounded on the grounds that international trade is a process from which all gain. A “win-win situation” as they put it. In general, I think they are right, but it would be foolish to deny that there is also a zero-sum dimension. As Paul Samuelson (2004)
has recently shown, there are situations in which one country’s gain is another’s loss.

If offshoring does result in the large-scale transfer of knowledge and skills to other countries, then it could theoretically weaken the sending countries by undermining their capacity to compete. The standard answer is that they should become even more inventive and even more skilled to make up for what they have lost to their rivals. This is certainly a desirable path to take. It helps to raise global income and ensure that international trade really is a win-win process. It is also in the long run the most viable option. Seeking to freeze the status quo by preventing knowledge and skills from moving offshore is a losing game in the modern world. If the objective is to keep jobs at home or maintain the national productive base, this is best achieved by doing things better than before. This is certainly the stance of the British government. In a number of speeches, the industry minister, Patricia Hewitt, has argued forcefully that protectionism is not the answer. At most, Britain should ask for a level playing field so that taxes, subsidies and regulations are not used unfairly to promote offshoring to the disadvantage of British workers. For example, a high rate of value-added tax is currently charged on contact-center operations if they remain in Britain but not if they are relocated to other countries. Some modification to these rules is suggested as a possibility in the aforementioned DTI report, but otherwise the report itself stresses that the response to competition must be positive.

The position of Hewitt, and of the British government in general, is summarized in the following passage from a speech she gave to the Confederation of British Industry on February 25, 2004:

First, we must create a system of world trade that is fair as well as free. We cannot demand market opening, sometimes overnight, from poor countries—while delaying market opening whenever it might hurt us . . . Second, we have to protect people without resorting to protectionism . . . But, as our economy changes, so will our jobs. And the faster the change in technology and trade—and however good for us as consumers—the more difficult the disruption will be for us as workers. I’m
not going to make the false promise that every job that exists today will still exist in ten years’ or five years’ or even one year’s time. But we can and we must promise that anyone facing the loss of their job will get the help they need. We’re not going to compete against India or China, or Poland or Slovenia on lower wages. We have to compete on quality. Enterprise, innovation, skills: that’s how we will sustain job growth, the lowest levels of unemployment and the highest levels of employment that we’ve seen for decades.

The damage caused by foreign competition and the ability of the government to deal with this damage depends crucially on the health of the economy at large. If the economy is depressed and the demand for labor is weak, then displaced workers may find it very difficult to find alternative employment. And if they do, the wages may be much lower or they may only get their jobs at the expense of others in the locality. This explains why the response to offshoring is more vehement in the U.S. than it is in the U.K., despite the fact that the number of jobs concerned is similar in relation to total employment. The American economy has been slow to recover from the 2001 recession and the demand for labor is still quite weak, whereas the British economy has enjoyed its longest period of uninterrupted growth in history. When the economy is booming, the overall demand for labor is strong and displaced workers can more easily find alternative employment. However, even under these circumstances, there will be many workers who experience serious financial and psychological costs when they lose their jobs. Thus, even in a booming economy an active policy of redeployment and compensation is required to deal with the casualties of foreign competition and to avoid the hostility it may otherwise provoke.

NOTES

1. The terms North and South are conventional short-hand for highly developed and less-developed countries. It should be kept in mind that the number of countries that belong to the South according to this definition is gradually shrinking as economic growth takes some of them into the highly developed category.

2. For further details of this trend, see Rowthorn and Coutts (2004), Table 2.

3. McCarthy’s study considers four main factors affecting the offshoring decision:
whether the service is delivered locally, whether the necessary skills are available off-
shore, to what extent technology supports the business process, and whether the
process is defined consistently and is well documented. Based on these factors,
McCarthy assigns a rank from 1 to 5 to each occupation indicating how rapidly jobs
are likely to move offshore in the future. For example, for occupations ranked at level
2, 1.5 percent of jobs are expected to move offshore by 2005, 3.5 percent by 2010
and 8.0 percent by 2015. The relevant percentages are then applied to 505 service
occupations defined by the Bureau of Labor Statistics to compute the number of
service jobs that are likely to move offshore. (This footnote is based on the summa-
ry of McCarthy’s method given in Garner [2004].)


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Part 3:
International Trade Policy & the Developing World
I.
A look at the recent WTO reports on the periodical Trade Policy Reviews of the United States\(^1\) will show that the concern about a resort to unilateralism has become a recurring feature of WTO discussions. The relatively recent but growing resort by the U.S. to bilateral and regional trade arrangements has caused widely shared concern in the WTO. Developing countries have repeatedly expressed their concern about the U.S. Trade Policy’s departures from multilateralism. It has also been a refrain of the EU and some other developed countries.\(^2\) Not that the EU itself is free of blame in this regard. The EU’s bilateralism and regionalism is not new. The EU’s recent initiatives in the same direction have also attracted similar attention in the WTO.\(^3\) Despite these voiced concerns, there appears to be a general scramble, as it were, to initiate or get on board the preferential trade arrangements. These trends have received attention in academia, and the political, legal and economic implications have been analyzed within theoretical frameworks.\(^4\) The phenomenon of departures from the multilateral principle is, however, not recent, notwithstanding the fact that multilateralism is reckoned as the very foundation of both

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S.P. Shukla was formerly India’s Ambassador to GATT and Finance Secretary of India.
the General Agreement on Tariffs and Trade, which came into existence in 1947, and the more recent agreement establishing the WTO, which was brought into force in 1995.

Those who criticize the departures from the multilateral principle as well as those who breach it (and the two identities are not always distinct) ritualistically swear their adherence to it. There seems to be an intuitive belief, particularly among the relatively weaker members of the trading system, that the multilateral process by itself would ensure not only the legality but also the fairness or equity of decision making. Once such belief triumphs over experience, it is only a short further step that leads to the proposition that a multilateral system is always desirable per se. The attention thus gets concentrated on the form rather than the substance, on the “geometry” (the “many-sided”-ness) rather than the “equity” (the norms and the rules, the way they are worked and their relative impact on the unequal sets of participants) of the system. The more basic question of the “power-relations” defining the system tends to get obfuscated. Such an environment is conducive to manipulation of multilateralism by the powerful few. The form retains the multilateral character, but the power-equation determines the substance. Some perceptive observers describe the phenomenon as the emergence of “disguised unilateralism” or “new regionalism.”

What is the essence of multilateralism? How was multilateralism practiced in GATT/WTO? What accounts for the hiatus between the law and the practice of trade policies? And, more important, what constitutes the necessary and sufficient conditions for success of multilateralism? This paper proposes to examine these issues conceptually as well as historically so as to explicate what appears to be implicit in the poser raised by the title.

II.

The origin of multilateralism in the trade policy context is traced to the concern in the international community over the disorderly state of affairs that prevailed in the two decades spanning the period between the two world wars. These decades were characterized by
repeated failures of international initiatives to bring some orderliness to international trade and monetary relations; competitive resort to unilateral exchange rate and trade and tariff policies leading to mutual impoverishment and general instability; and finally the traumatic experience of the Great Depression. The outbreak of the Second World War provided the immediate trigger for negotiations concerning the postwar international order. However, these negotiations were for the most part bilateral. The changing equation of power between the two main allied powers across the Atlantic and their respective concerns and experiences in the trade policy area left their indelible mark on the blueprint for the postwar order.

The fourth paragraph of the Atlantic Charter unveiled by Roosevelt and Churchill in August 1941, which has been hailed as the first enunciation of multilateralism as the basis of international economic order, said: “With due respect for their existing obligations, to further the enjoyment by all states, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity.” The qualifying initial phrase and the absence of the phrase “without discrimination,” which the U.S. had been insisting upon, meant that the British Imperial Preference was not in danger. On the other hand, the emphasis was unmistakably on furtherance of the mutual interest of the two signatories in access to raw materials and markets of the rest of the colonial world. The mention of “all states, great or small, victor or vanquished,” did not quite succeed in camouflaging this stark reality. The reference was to the warring nations of Europe, and primarily it sought to assure the public opinion in the enemy camp that eventually the “vanquished” too would be accommodated. And, of course, it totally overlooked the implication that the principle of “equal access” would continue to operate unequally in respect to those who were subjugated in the process of colonization.

Formally, the multilateral principle that emerged stood for equality of treatment or equity in international commercial relations; it promised a democratic postwar international order. In reality, it was
hardly universal in its ambit; it had the limited operational context of negotiations between the two major allied powers. This duality is its birthmark. It is also the root of the tensions and contradictions that have persisted in the system, as we shall see in what follows.

The exercise of working out mutually acceptable objectives and principles that should guide the shape of the postwar economic order was continued by the U.K. and U.S. in the negotiations on the Lend-Lease agreement. The Americans pursued their theme of unilateral dismantling of the Imperial Preferences by the British (that granted favorable trade considerations to Commonwealth countries), much to the annoyance of the latter. The British were concerned over the possible balance of payments problems that Britain would most likely face in the postwar period. They were also keen to maintain autonomy to follow full employment policies. They were, therefore, opposed to the American formulations of unqualified multilateralism and liberal trade, which seemed to pass on the burden of adjustment to Britain disproportionately. The American negotiators were hoping to impress their legislative masters by insisting on adequate “price” from the British for wartime supplies, holding the expectation of a *quid pro quo* for the wartime assistance to the U.K. This *quid pro quo* would, it was believed, assure the Congress that the wartime assistance was not given “free.” The compromise upshot of these negotiations emerged in the form of Article VII of the Mutual Aid Agreement, which, in the words of Jay Culbert, “became the cornerstone of postwar trade policy.” The operative portion of the Article reads:

... shall include provision for agreed action by the United States of America and the United Kingdom, open to participation by all other countries of like mind, directed to the expansion, by appropriate international and domestic measures, of production, employment, and the exchange and consumption of goods ... to the elimination of all forms of discriminatory treatment in international commerce, and to the reduction of tariffs and other trade barriers ... conversations shall begin between the two Governments with a view to determining, in the light of governing conditions, the best means of attaining the above-stated objectives by their own agreed action and of seeking agreed action of other like-minded Governments.
Clearly, the British concerns were taken on board to a great extent. No doubt, the American objective of elimination of the Imperial Preference was now explicitly recognized, but it was linked to reduction of high U.S. tariffs. While the language was multilateral inasmuch as the openness of the system to all like-minded governments was proclaimed, the whole process of negotiations and the formulation of objectives and principles remained strictly bilateral. The entire exercise of working out a full-fledged scheme of the world trade order that followed in pursuance of the Article VII negotiations would retain this bilateral characteristic right until the end of 1945, when the outcome of the negotiations came to be published.

The American side was developing, as part of the postwar planning exercise, “A Multilateral Convention on Commercial Policy” under the leadership of Harry Hawkins. In the U.K., James Meade developed “A Proposal for an International Commercial Union.” While the underlying approach of the two exercises was broadly similar, it was the latter which is acknowledged to be “the first definitive proposals for the postwar trading system.” The bilateral negotiations which commenced in 1943 in pursuance of Article VII ended in 1945 and the results were incorporated in a more inclusive document titled “Proposals for Expansion of World Trade and Employment” published by the U.S. Department of State in December 1945. A further elaboration of the American proposals titled “Suggested Charter for an International Trade Organization” was prepared in early 1946. In February 1946, the Economic and Social Council (ECOSOC) of the newly formed United Nations set up a preparatory committee to draft a convention for the consideration of an International Conference on Trade and Employment. It was at this stage that the subject matter was brought up, for the first time, for a wider, multilateral consideration in the form of the agenda of the preparatory committee. Interestingly, the membership in the preparatory process, although initially only 19 in number, represented all the three main tendencies (the developed capitalist world, the planned economies of the socialist world, and the emerging new third world of the ex-colonies and the periphery of the first world)
that were to dominate the trade and development debate in the three
decades that followed.\footnote{1}

The debates and negotiations in the preparatory process as well as
at the extended conference, which deliberated from November 1947
to March 1948, provide an insight into the inherent tensions and con-
flicts of interests that characterized it, and the Final Act of the
Conference, namely, the Havana Charter, represented the balance of
power among the major tendencies of the participants. Nevertheless,
the Havana Charter was informed by the substance of the multilater-
al principle, that is to say, it attempted to take on board the diverging
interests of different sets of participants, vastly differing not only in
terms of power and wealth, their respective histories and the nature
of problems confronting them, but also in terms of their vision of the
future. It was no doubt characterized by the major concerns of the
two powers that initiated the whole exercise of conceptualizing and
formulating the postwar economic order. But it also dwelt upon the
concerns of the other tendencies. And the compromise that it struck
had some discernible flavor of equity.

But history was proceeding at a faster pace than the negotiations.
The collocation of forces that gave the Havana Charter its flavor had
meanwhile undergone a major change. The cold war was already
afoot and the leading capitalist powers were more interested in the
consolidation of Western Europe as the bulwark against the “danger”
of communism. The USSR had exited from the process. The multi-
lateral principle was eclipsed by the \textit{real politick}. The Havana Charter,
and the way it sought to embody the multilateral principle, had little
relevance for the major capitalist powers in the changed situation. The
Charter was relegated to languish in limbo. All that survived was its
weak and truncated proxy brought into existence strictly for the
interim: the General Agreement on Tariffs and Trade (GATT) of
October 1947. Western Europe witnessed a massive boost in its bilat-
eral economic relations with the U.S. Then followed the Treaty of
Rome and the formation of the European Economic Communities.
The reality of “regionalism” and “bilateralism” was asserting itself,
while the legal shell of multilateralism persisted in GATT.
Equality, prosperity and stability were the three basic ideas that had inspired the planners of the postwar order, although the ambit of their conception was narrow and exclusive. The process that led to the formation of the Charter tried to extend that ambit and made it more inclusive. But with the premature demise of the Charter and its weak proxy now ruling the roost, the basic principles assumed a formal character—a narrow, technical and legal aspect, of relevance only for the *inter se* commercial relations of the industrialized members of the system. The non-discrimination principle embodied in the MFN clause continued to be treated as GATT’s essence. But it lost its soul. The system itself had become exclusionary and, therefore, discriminatory, leaving out the major part of the socialist world. More important for the burgeoning membership of the ex-colonial and the peripheral world, formal application of the principle of non-discrimination actually implied *further* discrimination, because “treating the unequal equally,” in the absence of substantive provisions to tackle their major trade problems, is a travesty of the equality principle. As for prosperity, the emerging third world countries needed assured provision of preferential opportunity and access in regard to markets, technology and capital, not just successive “rounds” of tariff cutting, which was taken by GATT as its main task. GATT also meant for them a negative, uncaring and unjust system because it paid little attention to fluctuating and unremunerative prices for their commodity exports, it did little to resist and eliminate the virtual closure of the rich markets for their agricultural exports, and it condoned a highly restrictive and discriminatory regime in regard to their competitive exports of textiles and garments. The GATT interface for *inter se* disputes among the members was essentially consultative and its preoccupation was largely the disputes between the trade majors. As a result, the idea of stability—based on positive and just principles governing *inter se* commercial relations of all the members—seemed to be, from the developing-country perspective, absent in GATT.

The entry of Japan into GATT in the 1950s was also illustrative of the dual character of the system. While the U.S. sponsored the
entry, a large majority of the developed countries in GATT virtually boycotted Japan through the use of the non-application clause provided in GATT. The rationale given by the industrialized countries for such a restrictive and exclusionary attitude was that their industry could not face the threat of competition from “low-wage” countries. This was as blatant as it was self-serving, for it cut at the very root of the principle of comparative advantage, which is supposed to provide the intellectual foundation of GATT.

For developing countries, a provision permitting restrictive trade measures, which was necessary to secure their external financial positions, was a positive feature. But this was essentially a counterpart of the similar provision found necessary by the developed members in the initial decade of GATT’s existence, and its extension with some amplification could not have been denied to developing countries. The relatively major move in GATT to address the problem inherent in “treating the unequal equally” came in response to the debate on trade and development that was going on in the United Nations forum and in the emerging coalition of developing countries. It was embodied in the addition of Part IV to GATT, which was long on rhetoric but short on effective mechanism. Later, again reactively, in the context of the formation of the United Nations Conference on Trade and Development (UNCTAD) in 1964 and the initiatives taken in that forum to work out an agreement providing the Generalized System of Preferences in the markets of developed countries for the exports of manufactures of developing countries, GATT first provided waivers and later incorporated the more formal agreement on the so-called Enabling Clause, both of which permitted departures from the principle of non-discrimination in favor of developing countries.

But by that time—as the 1970s progressed—the international environment for global capitalism was already undergoing a vast change. The expansionist phase was coming to an end. The oil crisis had altered the underlying assumptions of that phase. It appeared, for a while, as if the power equations of the postwar era were undergoing a change. The hegemonic role of the U.S. in providing the anchor
to the postwar economic order was weakening. Japan had already emerged as an industrial and trade major. The *inter se* competitive pressures between the EEC, Japan and the U.S. were growing severe. Incipient challenges were being perceived by the newly industrializing developing countries. GATT witnessed contradictory tendencies in these years. As stated earlier, on the one hand, the formalization of the agreement on the Enabling Clause, a positive feature bringing an element of equity into the system, took place. On the other, there was also the emergence of the “codes” on various aspects of international trade, i.e., agreements whose benefits were to be confined only to the signatories (who happened to be developed country members), which implied fragmentation of GATT, a fundamental structural departure from the multilateral and non-discriminatory architecture. Expansion of the scope and further accentuation of the restrictive regime regarding exports of textiles and garments also came into being in these years. Anxiety began to grow and was being articulated in developed country circles in terms of the “tyranny of the numbers” in the functioning of GATT, as the developing countries came to acquire an overwhelming numerical majority and, formally, every country had only one vote. All in all, the beginnings of the great regression that was witnessed in the 1980s and 1990s were already noticeable.

IV.

The 1980s witnessed accentuation of the crisis of global capital and consequent sharpening of the *inter se* conflicts in the developed world. It also saw a concerted offensive on the part of the developed world to explore new frontiers for their expansion. The former resulted in repeated trade conflicts between the three trade majors in GATT: the U.S., the EEC and Japan. The latter led to an eventually well-coordinated move on the part of the three to bring about a paradigm shift in the trading system embodied in GATT.

The story of the relapse of the trade majors, particularly the U.S., into GATT-inconsistent and GATT-illegal trade measures during those years is now too well known to bear repetition here. The deep
concern it caused in the developed world largely centered round the inter se trade conflicts of the three majors. Lester Thurow’s remark that “GATT is dead in the water” pointed dramatically to this state of affairs. The point being stressed was that the principles of open trade, comparative advantage, of a multilateral system operating with its rules to provide stability to the economic order, were being renounced in favor of protectionism, managed trade, bilateral deals of expediency and even “aggressive unilateralism.” No doubt, there was a qualitative change being experienced by the developed world in comparison with the workings of the trading system for the two and a half decades following the adoption of GATT. But this feeling of concern and even outrage rarely stressed the systemic inadequacies and inequities of GATT that developing countries had experienced since the very beginning. Nor the fact that the relapse also affected some developing countries, particularly those who were considered as promising economic spaces for expanding the frontiers of the operations of the multinational corporations of the developed world. On the contrary, developing countries were being dubbed as “free riders,” and were being eyed as potential targets not only for collecting the overdue “payments” for the “benefits” of the system that they had been enjoying but also for launching offensives in new areas of economic activities. And the trade majors, particularly the U.S., strategically used the instruments of “aggressive unilateralism” and bilateral pressures to compel the opponents of these moves to eventually fall in line.

The story of the Uruguay Round, during which GATT gave way to the World Trade Organization (WTO) at Marrakesh in 1995, has been variously told and this is not the place to repeat or even summarize it. What is pertinent to our present theme is that the systemic crisis of the 1980s was used deftly by the trade majors to bring about a paradigm shift in the trading system represented by GATT. The Uruguay Round was not merely some refinement, some institutional strengthening and some accentuation of a tariff-cutting exercise. It introduced for the first time new areas like intellectual property rights, alien to GATT’s trade mandate, into the system. It also put paid to the “cross-border trade in goods” character of GATT by bringing
within its purview an all-embracing and loosely defined area of services. It moved GATT beyond its role of a watchdog for trade, based on the comparative advantage principle, to the establishment and enforcement of international norms and standards on subjects hitherto squarely within national jurisdictions. And it introduced into the dispute-settlement process and mechanism the cross-retaliation possibility, enabling members to secure compensation for impairment and nullification of their rights in one area from another area within the system—a development that would, more often than not, only add strength to the elbow of the relatively stronger members of the system. On the whole, the outcome of the Uruguay Round is now widely perceived as having enhanced the inequity of the system.

The inequity and lack of legitimacy of the process of concluding the Uruguay Round negotiations and bringing the WTO into being could not be obfuscated either by the pretense of consensus decision making or the opacity of the negotiations in the last phase. The essence of the multilateral system is considered to be the principle of “unconditional application of non-discrimination,” that is to say, every member of the system being equally and unconditionally entitled to equal treatment. Leaving aside for the moment the paradox of “treating the unequal equally,” as discussed above, it should be obvious that introducing new or additional conditionalities for continued enjoyment of the existing privilege of the multilateral principle, without explicit and willing consent of every member of the system, would amount to withdrawal of the privilege from those members who do not see the benefit of the new conditionality and, therefore, are unwilling to accept the same. And if the new conditionality were nevertheless incorporated into the system, it would amount to the collapse of the multilateral principle. If the members so affected are precisely those who even otherwise are in a disadvantageous position because they are living in an unequal environment in the system, then the implications of the collapse are even more damaging for them. It is precisely by organizing such a collapse of the multilateral principle of GATT that the developed countries, particularly the three majors, accomplished the paradigm shift of the system from GATT to the
WTO. More serious, the condition of unanimity laid down by GATT for any modification of the multilateral principle through imposition of new conditionality or otherwise has now been substituted in the WTO by the rule of prescribed majorities, thereby opening up a continuing possibility of expanding the frontiers of the WTO to any new area whatsoever, and thus adding even newer conditionalities.10

V.
Since the agreement at Marrakesh, many attempts have been made by the apologists of the WTO system—the embodiment of the changed paradigm—to present it as a universally desirable development, largely a “win-win” situation. To press the point, the gains on the front of textiles and agriculture were highlighted, sometimes with a good deal of exaggeration as subsequent trends have shown, particularly in regard to agriculture. Some conceded some downside, but it did not affect their generally positive assessment. The more enthusiastic supporters were quick to build further on the triumph of Marrakesh. Indeed, the 1995 OECD Ministerial Report sought to replace the narrow principle of comparative advantage by the logic of “deeper integration” 11 and “internationally contestable markets” 12 to provide an intellectual foundation for the ever-expanding thrust of the WTO, to rationalize the compelling functional requirement of the transnational corporations arising out of their strategies and calculus of global operations. Within a short space of a couple of years after Marrakesh, a clutch of new issues again emerged as the possible agenda for the fresh round of negotiations, sought to be christened as “The Millennium Round.” Predictably, issues of labor standards and environmental norms, the question of laying down international norms and standards for investment and other capital flows, and bringing government procurement within the ambit of the WTO system13 formed the multi-prong offensive to push the theme of deeper integration. The offensive produced a strong reaction among the developing country members, who were by now acutely experiencing the lopsided nature of the multilateralism being practiced in the GATT/WTO system. A strong opposition also developed among sig-
significant sections of the first world peoples who were alienated by the ongoing process of “corporate globalization” and who identified the offensive launched in the WTO as part of that process—although their perceptions did not always coincide with the stance of developing countries on some issues, such as labor standards and environment and trade. The continued exclusion of a vast majority of developing country members from the decision-making process of the WTO provided the last straw, and the WTO ministerial meeting held at Seattle in 1999 to launch “The Millennium Round” ended in an unprecedented fiasco.

The efforts to resurrect the process were launched by the majors soon afterwards. The general atmosphere of uncertainty and outrage at the events of September 11th were adroitly exploited to push the themes of “multilateralism” and the launch of the new round of negotiations. In some articles appearing in the Western print media, subtle and not-so-subtle hints were thrown in to suggest that the opposition to the new round in the WTO could be perceived as a kind of economic version of the irrational forces of terror and anarchy challenging global security and order. The round was ultimately launched in Doha in 2001, but could raise the important new issues on the agenda only obliquely because of the continuing reservations and fears of the majority of developing countries. The showdown, however, came at the midterm ministerial meeting at Cancun in 2003, when in the face of the resolute opposition of an overwhelming majority of small developing countries to the commencement of negotiations on these issues, the offensive was temporarily called off. The impasse on the issue of agriculture created by the confrontation between the U.S.-EU combine and the Group of 20 countries, which included the influential developing countries of the three continents (Argentina, Brazil, China, India, Indonesia, South Africa and Egypt, among others) contributed considerably to the derailment of the meeting.

The developed countries succeeded in bringing the process of negotiations of the Doha Round back on rail at the Geneva meeting of the WTO in July 2004. The U.S.-EU combine was apparently able to extract a framework for conducting negotiations on agriculture
and the non-agriculture market access to their satisfaction through what appears to be a studied ambiguity built into the framework on agriculture, an ambiguity that could also provide, for the time being, a sort of consolation for the main players of G-20. The U.S.-EU combine also bought peace with a large number of small developing countries by offering to take the new issues of investment, government procurement and competition policy off the agenda of the multilateral negotiations. Notwithstanding the apparent success on the question of new issues, developing countries seem to consider the July Framework outcome as some loss of ground compared to the promise of Cancun.14

VI.
The developed countries’ tactical move to take the new issues of investment, etc. off the agenda of multilateral negotiations has some positive connotation for developing countries if viewed from a political standpoint. The emerging solidarity in their ranks has obviously raised concerns in the developed world. Even if we discount the on-the-spot petulant outbursts of the U.S. and EU representatives at Cancun after the derailment of the Doha process, their underlying deep concern should not be underestimated, particularly in the light of their growing resort to bilateral/regional trading arrangements, to which we referred in the very beginning of this paper.

As we have seen, the crisis in the trading system in the 1980s was overcome by the forces of global capital by transforming the paradigm of the trading system and imposing additional conditionalities to suit its requirement for further penetration into the new economic spaces (services) and strengthening its monopolistic hold on the knowledge and technology to maximize its returns, including rentier income, from that source (TRIPs). The design of the new “multilateral” system was bent to serve the requirements of the few. But the formal democratic structure was allowed to remain, perhaps because outright demolition of the structure would not have been easy, or because it was strictly not necessary considering the success that they had achieved in forcing down their decisions through the opaque
and self-serving procedures of decision making by consensus, a consensus garnished by bilateral arm twisting (remember “aggressive unilateralism?”) where necessary. The results appeared to them quite satisfactory; that is, until they witnessed the fiasco at Seattle. Their anxiety about the functioning of the WTO system deepened when in quick succession to Seattle they faced the derailment of the process at Cancun. Again, the numbers seemed to create the difficulties. So the obvious remedy seemed to lay in avoiding the large collectives of numbers. The easier and more efficient way of achieving the objective would appear to be to bypass and preempt such collectives through the bilateral and regional route. And this is what we are witnessing in the spurt of preferential trade arrangements: a tactical retreat from the formal “multilateralism” of the postwar era, a more direct and undisguised pursuit of expanding spheres of regional influence, with a view to neutralizing the potential resistance of the formal majority in the WTO and, eventually, once again transforming and further bending the multilateral instrument to meet the requirements of the few.15

If one looks at the characteristics of preferential trade arrangements (PTAs) that have emerged in the recent years, more particularly after the WTO came into being, the rationale of increasing resort to this route becomes clearer. In his excellent study of “Regional Trade Agreements in the GATT/WTO,”16 James Mathis analyzes this phenomenon, which he describes as “Modern Regionalism,” mainly from a legal point of view, but he also furnishes perceptive insights into its political and economic aspects. He has delineated certain features of those arrangements and has drawn conclusions about them. Placing them in the context of the analysis in the preceding sections, attempted from the standpoint of the South, we would recapitulate them as follows:

First, the end of the cold war has effectively removed the “real” constraint on the national prerogative of pursuing unilateral routes; the institutional constraint imposed by GATT was only a weak constraint, and the adherence to multilateralism as conceived in GATT and practiced by the major powers was really a function of the geopolitical constraint of the cold war. With that constraint gone, the major
powers are now free to pursue the unilateral route.

Second, many of the regional trade agreements under the WTO are either the initiatives of the U.S. or the EU or are in response to their earlier initiatives. The hegemonic character of the arrangements is, therefore, to be expected.

Third, while the focus on the regional agreements is evident (NAFTA, the EU and transition-economy countries, the Free Trade Area of the Americas hemispheric conception), not all of them (or all initiatives for such agreements) retain geographic proximity (EU-Mexico, EU-Mercosur, U.S.-African Growth and Opportunity initiative).

Fourth, multinational firms operate globally but have regional strategies and defend markets regionally. They lobby for regional preferences, including the investment regimes which help strengthen their competitive edge.

Fifth, the agreements include issues not within the purview of GATT/WTO but sought by the trade majors to be so included in the mandate of the multilateral system, e.g., services and investment provisions.

Sixth, while an agreement such as NAFTA underlines regional trade dependency, a number of PTAs show another type of dependency, namely, the large/small factor. Such agreements seem to promise large economic benefits to the small partner but confer unquantifiable political benefits to the larger partner. They take the “hub-and-spoke” form, which brings to mind the pre-GATT tendency of regional spheres of influence and a built-in dependency for the small nations, with all its consequences.17

Seventh, such agreements are a part of the process of attracting investment primarily from firms located in Europe and the U.S. by providing (a) free trade channels for the inputs and outputs of investments established and (b) certain legal guarantees to secure favorable treatment for investors. Investment obligations incurred by the host country can be without regard to mutuality. The dependency entailed by such arrangement can be more comprehensive across a broader range of traded factors than just goods.
In another more recent, brief but incisive article, appearing in *Asia-Europe Dialogue*, the U.S.’s forays into unilateralism and selective plurilateralism have been x-rayed. The conclusions reached reinforce some of the conclusions and observations mentioned above. The authors point out that the U.S. has entered into 23 bilateral Free Trade Agreements (FTAs) and is in the process of concluding similar agreements with 28 more countries. Barring NAFTA, the partner countries include mostly small countries with very low tariffs, small GDP and small trade turnover with little trade significance for the U.S. They also have high market dependence on the U.S. The agreements are, however, noteworthy as they include service sector liberalization, investment provisions and high intellectual property protection. Controversial issues like investor-to-state disputes and negative-list approach for services coverage are included. The large/small factor, high dependency and the strategy to bring in the controversial non-trade issues with a view to soften/eliminate the opposition to their inclusion in the WTO agenda are also the characteristics pointed out by Mathis in his study earlier referenced.

VII.

It would be appropriate to recall here that, from Jacob Viner to Jagdish Bhagwati, the free trade theorists of the neo-classical school have exposed the fallacy in the “primitive illusion” that greater *inter se* liberalization in a subset of a wider set of trading nations is always desirable, as it is a step towards freer trade. The question of discrimination against other members of the wider set implicit in such liberalization is important. Trade-creating liberalization is welfare improving, whereas trade-diverting liberalization is welfare reducing. And the final result is a matter of empirical assessment. The condition that *inter se* liberalization in the subset should be total or maximal does not by itself alter the position for the better; indeed, it may worsen it. In other words, PTA is no route to improvement of welfare through free trade, and hence, the inherent superiority of the multilateral approach to trade liberalization.
This exposition has, however, not dampened the enthusiasm for the preferential trade arrangements. Not only that, the history of the actually existing multilateral trading system has taken a course far different from that prescribed by the free trade theorists, as we have briefly analyzed in the preceding sections. Moreover, the last two decades of the period of so-called globalization have, if anything, witnessed more of the departures from the multilateral approach. So a reiteration of the free trade theory and the elegant proof of welfare-improvement through the multilateral route do not provide satisfactory explanation of the way the trading system has been evolving historically, nor do they help suggest policy guidelines for those weaker members of the system who are confronted with adverse trade and development outcomes.

Attempts have been made to bring into the analysis the political theory inputs to develop a more meaningful model to understand and explain the concept and functioning of multilateralism. Rorden Wilkinson has developed what could be called a “Keohane-Ruggie-Wilkinson” model of multilateralism, which he claims “can provide the means for laying open and thus making sense of the intricacies of the WTO’s legal framework”:

This model perceives multilateralism as a set of constitutive rules, which organize the relations of participants in accordance with the principles of indivisibility and diffuse reciprocity. These rules, in turn, authorize participants to act within a given behavioural range conducive with these core principles . . . But as a necessary corollary, to ensure that such behaviour is given rise to—that is regulated in the intended manner—multilateralism also entails an adherence to the principle of dispute settlement.\(^{21}\)

He makes an apparently modest claim that:

it is unlikely that specific or actual multilateralism will demonstrate anything other than a general propensity to adhere to these characteristics. Nonetheless, it gives us a basis upon which we can observe the difference between the ideal and an actual expression.
This model attempts to go beyond the superficial geometry of popular misconception of multilateralism. It also transcends the “algebra and calculus of opportunity and choice” of the elegant models of free trade and tries to found the analysis in terms of an understanding of history and the workings of multilateralism largely as seen from the standpoint of the developed world. But it also suffers from the major shortcoming of basing itself on unhistorical/partially historical/unwittingly biased concepts not in line with multilateralism as it was actually practiced by the trade majors and was observed and experienced by the majority of the members of the system who suffered exclusionary practices or were on the margins of the system.

Our account and analysis of the genesis as well as working of the multilateral trading system will show amply how the basic ingredients of the Wilkinson model do not fit the historical reality of the multilateral system. The concept of indivisibility is an unreal assumption. It presupposes equality and harmony subsisting between all the members of the system and integrity of interests binding them together. The exclusionary character of GATT and the reality of unequal members do not permit any presupposition of indivisibility. Rather, it is the contradictions and conflicts of interests and domination through manipulation that characterized the system throughout. According to the model, “diffuse reciprocity” differs from “specific reciprocity” only in that the former lacks the characteristics of immediate, specificity and definiteness of sequence of *quid pro quo*, which are the hallmark of the latter. Here too, in a set of unequals, non-reciprocity or preferential treatment (differential and more favorable treatment, to use the GATT jargon) is what is appropriate to the typical situation prevailing in the GATT/WTO system. It took GATT a full 30 years to give this perception a formal legal recognition. It follows that this shortcoming is a direct offshoot of the first shortcoming mentioned above. The third leg of the model, in the shape of a dispute settlement mechanism to ensure appropriate behavioral patterns, also suffered from a similar shortcoming. And the introduction
of the possibility of cross-retaliation has only worsened the deficiency of the system in the WTO.

In a word, there is little evidence, in the observed functioning of the multilateral trading system over the years, of “a general propensity to adhere to the characteristics of the model” as claimed by the author.

VIII.
What then is the more appropriate model of multilateralism that will both explain the way the trading system has actually worked and provide insights into the conditions for its success—that is to say, the conditions that would secure its essence, namely, an “unconditional right to equality of treatment for all the members”? We can only attempt here the basic elements of an approach to exploring the answer to this poser. Our analysis of the working of the actually existing multilateral trading system over the last five decades and more already provides some clues.22

First we have to make a decisive move away from the imaginary constructs of harmony and “win-win” models. We have to reckon with the reality of contradictions and conflicts of interest that characterized (and continue to do so) the working of the trading system. These contradictions and conflicts of interest were very sharp as they marked the birth of the system, and resulted in the exclusion of a large part of the postwar industrial world. They were not as sharp in the 25 years of the so-called “golden age of capitalism,” but they were always there, and became sharply visible again in the 1980s. In the first half of the 1990s, however, with the creation of the WTO, these contradictions and conflicts of interest were formally erased in the name of multilateralism, to the disadvantage of the large majority of the members. Despite this, they have persisted and even been exacerbated, causing the visible crises of the recent years.

Then we have to look for explanations for the way the system behaved and continues to behave: the underlying systemic causes that shaped the conflicts, if, and to what extent, they were an integral part of the functioning of the postwar capitalism. We have to identify what
is new in contemporary capitalism and how it is impinging on what happens in the WTO in the present times. We need to examine whether the basic contradictions in the functioning of capitalism in the metropolitan economies and their global spillover explain the dynamics of the system adequately and satisfactorily and whether we need to supplement the examination by introducing another level of contradiction in terms of the South and the North.

The travails of the negotiations, the long-drawn battles of concepts and formulations, have to be related to those underlying causes and forces. We must look for explanation of the eventual defeat of the South in many a battle in GATT/WTO and the emerging possibilities for regrouping. In that context, the question of identifying specific terrains of adversarial confrontation between the developed and developing members—and also the question of why some terrains yielded some results in terms of reducing, or indeed aggravating, the inequity of the system—acquire importance.

The “how” and “why” of the outflanking moves of the North need to be investigated and their potential of success gauged. The question of whether the North-South matrix adequately explains these moves, their twists and turns, needs to be addressed. In that context, the related question whether our inquiry requires introduction of another layer of contradiction—that within in each camp—also would need examination.

In our search for necessary and sufficient conditions for the successful working of true multilateralism, we would need to concentrate on the persisting antagonisms in the system and the structural and conjunctural possibilities, so as to discover the locus and agency for the desired transformation. In that context, the role of those elements in the organization who are bearing the brunt of the system’s inequity as it functions today would need to be assessed.

IX.

Finally, what elements do we gather from the historical analysis so far, as an early harvest (to use the GATT/WTO jargon)? In other words, pending the working out of the full-fledged explanatory formulation
and a theoretic construct in the light of the posers raised and point-
ers indicated above, what conditions can we discern, in the immedi-
ate context, that would help propel the functioning of the system in
the desired direction of an equality of treatment, or at least hold the
line and prevent further deterioration?

In the short run, a few strategic initiatives may be identified. First
and foremost, the emerging solidarity of the South in the WTO needs
to be nurtured. The emergence of G-20 and other larger formations
of groups of smaller African, Caribbean and Pacific countries, and
groups of even larger number of other developing countries on clus-
ters of issues, is a positive development. However, the movement from
the issue-based Groups of the South to the revival of the joint nego-
tiating capacity of the South on the lines of G-77 in the past, but
inclusive of China, is essential. As the WTO is launched on the course
of “deeper integration,” the trade weightage is not relevant. The stakes
of small and big countries are of equal weight now. And since the
“deeper integration” is in response to the forces of global capital
whose home is in the North, the adversarial confrontation between
the nation-states of the South and those forces of global capital is
unavoidable. And in order to prevent further aggravation of the
inequity of the system, this organizational initiative has a strategic sig-
ificance. It should lead to strategic use of the numerical majority of
the South in the WTO.

The paradigm of corporate, capital-intensive, export-oriented,
agribusiness-centered, peasant-insensitive and mass livelihood-endan-
gering agriculture which informs the U.S.-EU approach to the inter-
national discipline on agriculture has posed unprecedented challenge
to the three-billion-strong third world peasantry. Unlike the issue of
intellectual property rights that initially touched only a relatively
small section (until the implications for health care via the HIV/AIDS
crisis made it a people’s issue not only in the affected South but also
in the North, which eventually did lead to some dilution of the
inequity of the TRIPs agreement), the agriculture issue touches all
developing countries and their large masses of people directly and
acutely. The possibilities of the mobilization of the South on this issue

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in the WTO are considerable. This is, therefore, a likely terrain that can yield successful results in preventing further aggravation of the inequity of the system. One important condition for such mobilization is that G-20 must explore with the rest of developing countries an alternative paradigm for international discipline on agriculture.

Considering the outflanking moves of the North via the PTA route, it is of importance for the solidarity of the South to initiate two countermoves in this context. First, a revival of the idea of a code for transnational corporations operating in the South. This should be looked at as a possible balancing move in response to the recent spurt in the one-sided bilateral arrangements granting privileges to transnational corporations in regard to investment regimes and other matters. Second, an initiative from the South to call for re-examination of GATT Article XXIV, which is providing a license to the hegemonic powers for all kinds of departures from the multilateral principle to the detriment of developing countries. The immediate objective should be to plug the free trade area loophole, which provides such license.

NOTES

8. The Committee had a membership of nineteen, which included, besides the U.S. and U.K., the USSR, France, Canada, Belgium, Netherlands, Norway, Luxembourg, Czechoslovakia, Australia, New Zealand, China, Brazil, India, South Africa, Chile, Cuba and Lebanon. See also Wilcox (1949): “In their approach toward the problems of trade policy, the countries participating in negotiations now fall into four major groups. In the first group, which includes the United
States, Canada, Belgium, Holland, and the Scandinavian countries, there is a strong desire to reestablish a world trading system based on multilateralism and non-discrimination. In the second group, which includes Great Britain and France, recognition of eventual desirability of multilateralism is overshadowed by preoccupation with the immediate necessities of reconstruction. In the third group, which includes most of the countries of Latin America, Asia, and the Middle East, the predominant concern is with the promotion of industrial development. The fourth group, which includes the countries of Eastern Europe, is committed to collectivism.”


11. “Deeper integration” refers to the incorporation of non-trade issues, such as environmental or labor standards, into the mandate of the WTO.

12. The concept of “internationally contestable markets” seeks to ensure provision of market access and opportunities for foreign firms, equivalent to domestic firms, and make those markets open to global competition. See Zampetti and Sauve (1996).

13. Introduced at the 1996 Singapore WTO ministerial, WTO provisions for government procurement would effectively bar governments from giving preference to local suppliers of goods and services, opening the procurement process to international competition. See the statement by Martin Khor, of the Third World Network, to the Group of 15 Meeting of Trade and Economic Ministers, Jakarta, May 27, 2001.


15. In the context of the emerging “multipolar” trading system as a result of the trade hegemons’ growing resort to preferential trade arrangements (PTAs), Jagdish Bhagwati comments on the phenomenon thus: “... [D]o the WTO rules themselves get adjusted to reflect what the ‘hegemon’-centered PTAs have enacted[?] The latter has been the case, in my view, with intellectual property protection; and it is being asked for when the United States, for example, negotiates a Free Trade Agreement with Jordan, builds linkages to labor standards into it, and then declares that this is a ‘template’ for others to follow! The ‘normative’ question then is: should we approve of this role of PTAs? In terms of international relations theory, this amounts to ‘divide and get your way’: changes which are not negotiable with, say, developing countries on IPP [the Intellectual Property Protection] and on labor standards in multilateral negotiations, are accepted by weak or small developing countries as Jordan and Singapore in one-on-one bilateral PTAs by a hyperpower like the United States, and the coalition of the developing countries at Geneva in multilateral negotiations begins to break down.” See foreword to Mathis (2002).

17. See Runato Ruggiero, former WTO Director-General (1997): “If the logic of regionalism often makes less economic sense in an era of globalization, why are we witnessing such a dramatic expansion of regional initiatives? Perhaps part of the answer could be that in some cases these initiatives are less about advancing regional economic efficiency or cooperation . . . and more about securing regional preferences, even regional spheres of influence, in a world marked by growing competition for markets, for investment and for technology.” Quoted in Mathis (2002), p. 127.


19. Examples of such disputes are those provided under NAFTA’s Chapter 11 on investment, which allow private firms to bring suits against governments that infringe upon their investment rights and receive cash remuneration for investment damages.

20. Negative lists allow liberalization of trade unless specifically prohibited by provision in an FTA. In the service sector, this means that the development of new services can not be protected from international competition under an existing FTA.


22. The approach suggested here (which also informs the historical analysis of the actually existing multilateral trading system in the preceding sections of this paper) is inspired by Maurice Dobb’s seminal essay “Marxism and the Social Sciences.”

23. The Group of 77 (G-77) was established at the end of the first UNCTAD session in 1964, with the mandate of providing “the means for the developing world to articulate and promote its collective economic interests and enhance its joint negotiating capacity on all major international economic issues in the United Nations system, and promote economic and technical cooperation among developing countries.” It currently encompasses 132 nations, but retains its original name.

**REFERENCES**


I. SUMMARY
In recent years, new trade agreements have often been promoted on the basis of their potential benefit to developing countries. Political leaders, international financial institutions and even advocacy groups have argued that rich countries such as the United States have an obligation to expand trade in order to help poorer countries grow and develop.

These claims are often grossly exaggerated, as can be seen from an examination of the economic literature on trade. Furthermore, there are costs associated with trade liberalization in the developing countries, and with the changes required by such agreements as the WTO’s TRIPS (Trade-Related Aspects of Intellectual Property Rights). When the benefits and costs of continued liberalization along the lines set out in these agreements are evaluated according to standard economic research, it is not clear that the developing countries as a group are facing a net gain.

Regarding the gains from increased access to the markets of rich countries:

Mark Weisbrot and Dean Baker are Directors of the Center for Economic and Policy Research. The authors would like to thank Debayani Kar, Simone Baribeau, and Andrea Blatchford for their comments, research and editorial assistance.
• The removal of all of the rich countries’ barriers to the merchandise exports of developing countries—including agriculture, textiles and other manufactured goods—would result in very little additional income for the exporting countries. According to the World Bank’s estimates, when such changes were fully implemented by 2015, they would add 0.6 percent to the GDP of low- and middle-income countries. This means that a country in sub-Saharan Africa that, under present trade arrangements, would have a per capita income of $500 per year in 2015, would instead have a per capita income of $503.

• Some of the most widely used economic models show that many developing countries will actually lose from trade liberalization in important sectors, such as agriculture and textiles. There are three reasons for this outcome. First, some countries will be hurt by the elimination of quotas that now allow them to sell a fixed amount of exports at a price that exceeds the competitive market price. Second, trade liberalization changes the relative prices of various goods, and some countries will find that their export prices fall relative to the price of imports (the “terms-of-trade” effect). Third, some developing countries currently benefit from access to cheap, subsidized agricultural exports from the rich countries.

In standard trade models, the gains to developing countries from removing their own barriers are much greater than the gains from increased access to the markets of rich countries. However, developing countries also incur substantial costs from opening their markets, which are often overlooked:

• Developing countries incur substantial problems from reducing their trade barriers. In many developing countries, tariff revenue accounts for 10-20 percent of government revenue, and in some cases considerably more. If tariffs are reduced or eliminated, these countries will have to impose large increases in other taxes in order to keep their budgets in line. The dis-
tortionary effect of these tax increases, as well as the costs and problems associated with collecting taxes from other sources, are generally ignored in economic models that project gains from eliminating trade barriers.

- The removal of trade barriers is also likely to lead to large disruptions in agriculture. In most developing countries, a large portion of the population is still tied to the agricultural sector. If barriers to agricultural imports are removed too quickly, it can lead to large-scale displacement of the rural population. Standard economic models implicitly assume that these people are re-employed in other sectors of the economy, but rapid import liberalization can lead to substantial unemployment and underemployment, as well as dangerous levels of social and economic instability.

There are two other sets of costs that have been attached to trade liberalization that must also be taken into account:

- Recent trade agreements, such as the TRIPS provisions in the WTO, have sought to impose U.S.-style patent and copyright protections in developing countries. This will lead to the transfer of billions of dollars from developing to high-income countries in the form of royalties and licensing fees. In addition, the efficiency loss resulting from higher prices of patented and copyrighted items is likely to be even larger. The World Bank’s estimates indicate that the cost of TRIPS to developing countries is likely to be comparable to any gains they might receive from trade liberalization.

- As a result of increasing instability in world financial markets, developing countries have felt the need to vastly increase their holdings of foreign exchange reserves. These reserves are held in the form of short-term deposits that pay little or no real interest. By contrast, this money could otherwise be invested in building up the infrastructure or the physical and human capital in a developing country. The opportunity costs of these
increased reserve holdings are also of the same magnitude as the World Bank’s projections for the benefits of trade liberalization.

The implication of this analysis is that developing countries may benefit at least as much from measures such as the repeal of TRIPS, or a restructuring of the international financial system that restored its stability, as from any progress on trade liberalization. At the least, the costs associated with these changes deserve much more attention in policy discussions than they have thus far received.

Furthermore, if the costs and benefits of increased liberalization along the lines of recent agreements are evaluated according to standard economic research and evidence, there is no basis for assertions that these policies will qualitatively improve the plight of the poor in developing countries. In fact, the research provides substantial evidence that these policies may actually cause a net loss for low- and middle-income countries as a group.

II. THE RELATIVE IMPACT OF TRADE LIBERALIZATION ON DEVELOPING COUNTRIES

It has become a standard refrain in policy circles that expanded trade holds the key to prosperity for developing countries. According to this view, if the industrialized countries would eliminate their trade barriers, especially in apparel and agriculture, this would provide a basis for growth in developing countries, pulling hundreds of millions of people out of poverty. As the World Bank wrote in its latest Global Economic Prospects: “A reduction in world barriers to trade could accelerate growth, provide stimulus to new forms of productivity-enhancing specialization, and lead to a more rapid pace of job creation and poverty reduction around the world” (World Bank 2002, p. xi).

The evidence for this view is considerably less compelling than its proponents imply. While there are certainly reasons for believing that expanded trade can help to promote growth in developing countries, it is unlikely that trade liberalization, by itself, will qualitatively improve the plight of people in the developing world. In fact, there are plausible scenarios in which trade liberalization can actually lead to worse outcomes for developing countries.
Moreover, it is not clear that trade liberalization is the key to rapid growth and development. It is worth noting that the major success stories in the developing world—most notably South Korea and Taiwan, which now have income levels comparable to the poorer industrialized countries—but also countries that have more recently experienced accelerated growth rates, such as China and India, have not followed a simple path of trade liberalization. In all of these countries the government has played an important role in guiding the economy. This guidance has included subsidies and protection for favored industries and restrictions on capital flows, policies generally opposed by the leading proponents of trade liberalization. In many respects, the path of trade liberalization currently promoted by the World Bank and others can be seen as directly opposed to the development strategies that have proven most successful in the postwar period.

This chapter has three parts. The first examines the assumptions and projections of the computable general equilibrium (CGE) models that provide the basis for the claims about the beneficial impact of trade liberalization. One of the main conclusions from these models is that most of the projected gains from trade liberalization do not come from the removal of trade barriers in the industrialized countries—rather the biggest source of gains to developing countries is the removal of their own barriers to trade. In principle, these gains would be available whether or not the industrialized countries also followed a path of trade liberalization.

The chapter then briefly discusses some of the reasons why developing countries may not choose to liberalize, in spite of the potential gains implied by the CGE models. The two most obvious considerations are the loss of revenue due to tariff reductions and the economic and social disruptions caused by rapid displacement of workers from agriculture.

The chapter then details two possible sources of large economic losses to developing countries if they follow the type of liberalization path currently being advocated by the World Bank, the IMF and other international economic institutions. Specifically, it notes the transfer of income to industrialized countries—in the form of royalties and
licensing fees—which would result from the application of U.S.-style patent and copyright laws. It also notes the potential costs of increased reserve holdings. In recent years, developing countries have felt the need to maintain very large reserves of foreign exchange—money that gets very low returns—in order to maintain the stability of their currencies. This imposes a substantial drain on their economies. These potential sources of losses to developing countries have been largely ignored by advocates of greater trade liberalization. In many cases, these losses could plausibly exceed the gains from trade liberalization.

III. GAINS FROM TRADE: WHAT THE MODELS SHOW

The most striking feature of trade models is their ability to project wildly different outcomes when modeling an identical policy. For example, in 1994 the President’s Council of Economic Advisors projected that the Uruguay Round of the GATT, which created the WTO, would add $100-200 billion annually to GDP in the United States (1.0 percent to 2.0 percent) when fully phased in (Economic Report of the President, 1994, p. 234). By contrast, a model developed by Drusilla Brown, Alan Deardorff, and Robert Stern (BDS), all prominent supporters of recent trade pacts, shows that the Uruguay Round would add just $12.9 billion to GDP, less than one eighth as much (BDS 2001, Table 1). Figure 1 shows the differences in these projections.
Large divergences between model projections are commonplace in the trade literature. Figures 2a and 2b show projections of the gains to the United States and Canada, respectively, from the U.S.-Canada Free Trade Agreement. The models show widely differing numbers and in fact do not even agree on the net welfare effects. One of the models projects that the United States would incur a small welfare loss as a result of the agreement, while the other three show it gaining. In the case of Canada, two of the five models project welfare losses. Among the three models showing gains, the largest projected gain was more than 16 times the size of the smallest. (It is worth noting that this largest projection was the one most widely cited in public debates over the trade agreement in Canada [Grinspun, 1993].) Other simulations of trade policies, such as the modeling of a new WTO round of trade liberalization, have produced similarly divergent projections.

There are two main reasons for the large differences in projections between models. The first reason is that there will always be some differences in the structure and estimates used in different models. There is no fixed, unambiguous way to model trade policy. Any model is necessarily incomplete, and decisions must be made as to which countries and industries to include. In addition, it is necessary to estimate various effects—for example, the extent to which the demand
for sugar increases as a result of a fall in the price. These estimates will differ depending on the time and place for which the estimate is made. For these reasons, it should be expected that no two trade models will produce identical projections of the impact of a particular trade policy.

But this source of differences across models is comparatively small. The more important reason for the differences across models is that there are many different effects of trade that economists have sought to model. Some of these effects are fairly well understood. For example, the standard view of gains from trade is that the reduction of trade barriers will increase economic efficiency by allowing consumers and producers to buy items from the lowest cost source. The logic and mechanics of this argument are well understood by economists. However, in recent years economists have sought to model other possible effects of trade that are much less well understood. These include the possibility that many industries have increasing returns to scale, which will magnify the effects of any trade-induced growth; that increased trade will lead to more rapid capital accumulation; and that expanded trade can increase productivity throughout the affected industries. These secondary effects are poorly understood and lead to widely divergent estimates of the gains from expanded trade. As the World Bank commented on the impact of expanded trade on productivity, “much more work needs to be done in this area” (World Bank 2002, p. 167). Given the limited theoretical and empirical basis for these secondary effects of trade, it is difficult to argue that projections of gains from trade that are largely speculative in nature should provide the basis for public policy.

There is a similar problem with the treatment of liberalization of services. In recent work, the World Bank estimated that the gains from liberalizing trade in services were more than four times as large as the gains from removing barriers in merchandise trade (World Bank, 2002, pp. 168-173). Similarly, BDS estimated that the gains from liberalization in the trade of services were nearly 80 percent
higher than the gains from the liberalization of trade in agriculture and manufactured goods (BDS 2001, Table 5). A major problem with these estimates is that it is very difficult to measure the size of government-imposed barriers to trade in services. These barriers do not take the form of tariffs or quotas, but rather appear in the form of government regulations and restrictions that prevent foreign corporations from entering the domestic market. As a result, it is necessary to use indirect measures of the resulting inefficiencies. In the case of BDS, the measure of relative inefficiency used in the model is the gross profit margin—the gap between price and variable costs for industries providing services in each nation. BDS view the gross profit margin as evidence of inefficiency.

Closer examination suggests that this method may not provide an accurate measure of the extent of protection and the relative efficiency of services in various countries. For example, as Dorman (2001) notes, this measure implies that the service sector in the United States is considerably less efficient, and therefore more protected, than the service sector of most other countries, since gross profit margins are reported as being above average in the United States for most categories of services (BDS, 2001, Table 4). It is also worth noting that even within countries there are very large differences in gross profit margins for the same type of service. For example, The Gap, a major clothing retailer was reported as having a gross profit margin of 42 percent in 1999, which had dipped to 31 percent just two years later (“Frugal Shoppers Worry Retailers,” New York Times, 12-17-01, sec. C). By contrast, Wal-Mart reportedly had a gross profit margin of just over 21 percent. The fact that such large differences in gross profit margins can exist between retail stores suggests that factors other than trade restrictions are responsible. There are real differences in the quality and convenience of the service provided in different stores, which consumers apparently value. Other features of stores are also likely to matter to consumers—for example, whether it is located in a suburban strip mall or in the middle of the city. Assuming that differences in gross profit margins are attributable to protectionism
implies that such issues as service quality and convenience do not matter to consumers.

Clearly, many countries have substantial barriers to the entry of foreign corporations seeking to provide services to the domestic market. In many cases, these barriers undoubtedly do lead to serious inefficiencies. In some cases, the impact of barriers may be difficult to assess. For example, restrictions on Wal-Mart-type discount stores may protect central city shopping districts. These districts may be viewed by the people in a specific country or region as having valuable externalities. They may also help to make an area attractive as a tourist destination for people outside the area. For example, it is unlikely that Paris would be as popular a tourist destination if Wal-Mart had dominated the French retail market to the same extent as it dominates the U.S. retail market. Economists’ ability to accurately assess the benefits of removing barriers in services is very limited, as the World Bank notes: “the quantification of services sectors’ trade barriers and other forms of protection is still more art than science” (World Bank, 2002, p. 170). At this point, the projections of gains from the liberalization of services must be viewed as highly speculative. It would be foolhardy for any nation to conduct policy based on theory and evidence that is so poorly developed.

There is one other set of issues that should be noted about these trade models. It is a standard assumption in all of these models that resources are fully employed. Concretely, this means that workers in declining sectors who lose their jobs due to trade liberalization find themselves re-employed in sectors that expand. Obviously, this does not reflect economic reality, in which many displaced workers experience a significant period of unemployment. However, at some point the displaced workers will presumably have been re-employed or have left the labor market due to old age. In this sense, these models must be viewed as long-run models that project the effects of trade liberalization, after some adjustment period.

These models also include an unrealistic assumption about the replacement of lost tariff revenues. They assume that the tariff revenue
lost as a result of trade liberalization will be offset by increasing lump sum taxes. Lump sum taxes are an artificial construct. They effectively imply that tax revenues are just sucked out of the economy—they are not taxes on specific items like capital or labor income. From the standpoint of these projections, the modeling of an artificial lump sum tax, rather than real world taxes, leads to an overstatement of the gains from trade. Any real world tax will lead to economic distortions, reducing the projected gains from trade liberalization.

In most industrialized countries, tariff revenues are relatively unimportant—accounting for only 1-2 percent of total government revenue. However, in developing countries tariff revenues generally comprise a much larger share of national revenue, generally more than 10 percent and in some cases more than 30 percent. The replacement of lost tariff revenue will be a far more important economic and political issue in developing countries. This issue will be discussed at somewhat greater length in the next section.

With these qualifications, it is worth examining more closely what these models imply about gains from the reduction of trade barriers. First, it is important to realize that countries do not necessarily benefit from trade liberalization, even in the most basic models. There are three reasons for this. The first is the “terms of trade effect.” This means that trade liberalization affects the relative prices of various goods. For example, trade liberalization could lead to a large decline in the price of computer chips relative to most other goods. If a nation like South Korea relies a great deal on computer chips for its export earnings, and the goods it imports do not experience any comparable decline in price, then South Korea could end up losing from world-wide trade liberalization.

A second reason that countries could lose by trade liberalization is that many countries can directly benefit from protection in their export markets. Specifically, if one country’s exports to another country are restricted by import quotas, it implies that they are able to sell their exports at an above-market price. For example, if Pakistan’s exports of shirts to the United States are restricted by an import
quota, then the standard theory implies that Pakistan will be able to charge an above market price for each shirt that it sells in the United States. If the United States drops all quotas and tariffs on imported shirts, then the price of shirts in the United States will fall to the world market price. Pakistan would no longer be able to collect a premium (or “quota rent”) on each of the shirts it sells. It may be able to sell more shirts in the United States after the trade barriers are removed, but it is entirely possible that the gains from selling more shirts will not offset the lost quota rents. In this case, Pakistan would lose from trade liberalization by the United States.

A third way that countries could end up with net loss as a result of trade liberalization is that they may be large consumers of subsidized exports. If a country eliminated its subsidies on these exports, then in standard models the importing country could lead to a loss to the importing nation. For example, if a country is a major consumer of subsidized wheat exports from the United States, and the United States then removes these subsidies, the importing country would be in a situation where it now has to pay more for the wheat it purchases. Obviously developing countries would benefit more from lump sum payments than subsidies attached to specific exports. Also, as a practical matter, subsidized exports could retard the development of domestic agriculture and industry in developing countries. But in standard trade models, the loss of export subsidies could be detrimental to at least some developing countries.

The fact that trade liberalization can be detrimental to developing countries is shown by estimates that BDS made of the impact of the Uruguay Round. Figure 3 shows the BDS estimates of the losses accruing to a series of developing countries as a result of the agricultural liberalization required by the Uruguay Round. The losses shown are the projected decline in annual GDP for each nation after the agreement has been fully implemented. In some cases the projected losses are substantial. For example, the projected losses for the Philippines and Indonesia are equal to 1.1 percent and 1.0 percent of GDP, respectively. This would be equivalent to losses of $110 billion and $100 billion a year in the United States, respectively.
Figure 4 shows the losses that BDS projected for several countries from the phase out of the multi-fiber agreement; this phase-out was another part of the Uruguay Round agreement. These projected losses are not as large as the losses that some countries are projected to incur from agricultural liberalization but they are not completely inconsequential. For example, the loss shown for Malaysia is equal to 0.16 percent of GDP. This is larger than the gain of 0.14 percent of GDP that BDS projected for the United States from the combined effect of all the aspects of the Uruguay Round.

Of course, these projections are for just part of the Uruguay Round agreement. Some of these countries were projected to be net
gainers from the agreement taken as a whole, although BDS project-
ed that Indonesia, Mexico and its groupings of Central and South American and Middle Eastern countries would be net losers from the entire agreement. But the exact estimates of this particular simulation are not important. The more important point is that trade liberaliza-
tion does not necessarily lead to gains for developing countries. As the BDS model indicates, the loss of quota rents, the worsening of terms of trade and the elimination of export subsidies from the industrial-
ized countries can cause developing countries to lose from trade lib-
eralization. The fact that the projected losses in this model mostly result from the liberalization of trade in textiles and agriculture con-
tradicts the simplistic view that greater market access in these areas will always be beneficial to developing countries. While they may benefit in many circumstances, as the BDS model shows, developing countries can also lose from the removal of developed-country trade barriers in these sectors.

The World Bank’s analysis of trade liberalization is useful because it provides a breakdown of the projected benefits between the industri-
alized and developing countries from each type of trade liberalization. Figure 5 compares the gains to developing countries that are project-
ed from the removal of merchandise trade barriers in the industrialized countries with the gains that they are projected to receive from removing their own barriers. The total gains to developing countries from reducing their own barriers are substantially larger than the gains they are projected to receive from the reduction of barriers in the industrialized countries. This gap is attributable to the large difference in the benefits to developing countries from liberalization in agricul-
ture. The benefits from liberalization in the industrialized countries are projected to be just 0.3 percent of developing countries’ GDP in 2015, while the benefits to developing countries from their own liberaliza-
tion in agriculture are projected to be more than three times as large, at 1.1 percent of GDP. Overall, the gains to the developing countries from liberalizing their own merchandise trade barriers are projected to be 1.2 percent of GDP, compared to 0.6 percent of GDP from liberal-
alization in the industrialized countries.
The fact that developing countries stand to gain much more from their own liberalization than from the removal of trade barriers by the industrialized countries is a predictable result of these sorts of models. In most sectors, trade barriers in the industrialized countries are already low. By contrast, most developing countries maintain much higher tariff and quota barriers. This means that in these models, the elimination of the developing countries’ own import barriers will have much more impact on their economies than the elimination of the barriers to their exports by the industrialized countries.

The next section will examine factors that may discourage developing countries from engaging in the sort of liberalization advocated by the World Bank, in spite of the projected gains. But first it is worth putting these gains in some context. The cumulative gain projected to accrue to developing countries from merchandise trade liberalization in the industrialized countries is 0.6 percentage points of GDP, after it is phased in between 2005-2015. This translates into an increase in the growth rate of approximately 0.05 percentage points annually. The 1.2 percentage point gain projected to result from their own liberalization would translate into an increase in the annual growth rate of approximately 0.09 percentage points annually. The combined projected impact of liberalization in all regions is 1.7 percentage points, which would add approximately 0.12 percentage points to the annual growth rate.

Figure 6 compares the projected gains to the annual growth rate that would result from the trade liberalization modeled by the World Bank with the average annual rate of per capita GDP growth in South Korea over the four decades from 1960 to 2000. It also includes the
average per capita growth rate projected by the World Bank for the countries of Latin America and sub-Saharan Africa over the next 10 years. The gap between the growth rate in South Korea over this four-decade-long period and the growth rate projected for Latin America is 4.1 percentage points. The gap with sub-Saharan Africa is 4.9 percentage points. If all developing countries benefit equally from the trade liberalization modeled by the World Bank, then the projected gains would close 2.9 percent (not percentage points) of the gap in the growth rate between South Korea and Latin America and 2.4 percent of the gap in the growth rate between South Korea and sub-Saharan Africa.

In other words, the World Bank’s projections imply that trade liberalization would only move developing countries a very small fraction of the way towards the sort of rapid growth experienced by South Korea or other successful developing countries. While higher growth should be viewed as beneficial—other things being equal—the increments to growth that are implied by the World Bank’s projections would have very little impact on the living standards for people in most developing countries. The first column in Table 1 shows the current per capita GDP for several developing countries. The second column shows the projected per capita GDP for 2015, assuming no trade liberalization. The third column shows
projected per capita GDP for 2015 including the gains from trade liberalization described above.  

<table>
<thead>
<tr>
<th>Per Capita GDP (in 2000 dollars)</th>
<th>2000</th>
<th>In 2015, without trade liberalization</th>
<th>In 2015, with trade liberalization</th>
<th>In 2015, with South Korean growth rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>$5,040</td>
<td>$6,209</td>
<td>$6,312</td>
<td>$12,081</td>
</tr>
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<td>Argentina</td>
<td>12,050</td>
<td>16,458</td>
<td>16,732</td>
<td>28,884</td>
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<td>Bangladesh</td>
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<td>2,782</td>
<td>2,828</td>
<td>3,811</td>
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<tr>
<td>Bolivia</td>
<td>2,360</td>
<td>3,223</td>
<td>3,277</td>
<td>5,657</td>
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<td>Ethiopia</td>
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<td>801</td>
<td>814</td>
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<tr>
<td>India</td>
<td>2,340</td>
<td>4,094</td>
<td>4,162</td>
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<tr>
<td>Indonesia</td>
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<td>5,968</td>
<td>6,063</td>
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<td>Kenya</td>
<td>1,010</td>
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<td>Mexico</td>
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<td>3,254</td>
<td>3,309</td>
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<tr>
<td>Peru</td>
<td>4,660</td>
<td>6,365</td>
<td>6,470</td>
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<td>Sierra Leone</td>
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<td>South Africa</td>
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<td>Turkey</td>
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<td>4,794</td>
</tr>
</tbody>
</table>

* See Appendix 1
While these countries would clearly be better off if the World Bank’s projections prove to be correct, and they are able to achieve additional growth as a result of trade liberalization, this gain would probably not make a qualitative difference in their well-being in 2015. It is worth noting that the gains the World Bank projects these countries will experience after 15 years of trade liberalization will have roughly the same impact on living standards as would the difference between the growth rate in South Korea and that of most other developing countries after a three-month period.

IV. WHY DEVELOPING NATIONS MAY NOT CARE ABOUT THE ECONOMIC MODELS

The discussion in the prior section noted that most of the gains from trade that developing countries are projected to receive result from their own liberalization, not the removal of trade barriers by the industrialized countries. Yet, developing countries (like industrialized countries) are generally reluctant to engage in unilateral trade liberalization. This reluctance would appear to be foolish—even if the gains from trade liberalization are relatively modest, countries should still prefer policies that will make them better off. However, there are good reasons that developing countries may opt not to follow an ambitious route of trade liberalization, even if the positive gains predicted in the models proved accurate.

Any economic model requires a large number of simplifying assumptions in order to make it tractable. The models used to project the impact of trade are no exception. This is not necessarily a problem, unless the simplifying assumptions exclude issues that are important to understanding the impact of trade liberalization. The prior section noted two simplifying assumptions that may distort the evaluation of trade liberalization in fundamental ways:

1. tariff revenues are assumed to be replaced by non-distortionary lump sum taxes, and
2. the adjustment process from declining industries to growing ones is assumed to be quick and painless, and to have no impact on the net gain or loss to the country from trade liberalization.
Both of these assumptions are very much at odds with reality in ways that are likely to be especially important for developing countries.

The first issue, the replacement of lost tariff revenue, reflects both a technical flaw in the models and a major gap between the models and the reality that they purport to describe. The technical flaw stems from the fact that in standard economic models all real-world taxes (e.g., income taxes, payroll taxes, sales taxes, excise taxes, etc.) lead to economic distortions, which means that they will reduce output. Tariffs can also be thought of as one type of tax, which happens to be applied to goods that are imported into the country. The proper way to model the impact of tariff reductions on the economy would be to project the gains from eliminating one type of distortionary tax (i.e., tariffs) and replacing it with other distortionary taxes. The size of the benefits to the economy would depend on the extent to which the taxes that were raised to replace lost tariff revenue were less distortionary than the tariffs that were reduced. There is no guarantee that this tax shift will necessarily provide gains—it is possible that the taxes that are raised to offset the lost tariff revenue would be more distortionary than the tariffs, in which case the country would lose by cutting its tariffs.

This issue is evaded in both the BDS and World Bank models, because they assume that the lost tariff revenue is replaced by a lump sum tax, which creates no economic distortions. This assumption inevitably leads to an overstatement of the gains from trade, even if everything else in the model exactly reflected reality. While there are different assumptions which can be made about the taxes used to replace the lost tariff revenue (e.g., a proportionate increase in all taxes or an increase in specific taxes, which would arguably be the ones that are most likely to be raised to offset lost tariff revenue), a proper modeling exercise should show the impact of replacing one real-world tax with an alternative real-world tax, not with an imaginary tax that only exists in economic models.

This point is especially important for developing countries because they depend on tariffs for a relatively large percentage of their tax revenue. Table 2 shows the percentage of government revenue that comes from tariff revenue for a selected group of countries. For the
industrialized countries in the table, the percentage is very low. In the case of the United States, it is just 0.9 percent. By contrast, developing countries are far more dependent on tariff revenue. Many developing countries, such as Egypt, Venezuela and Pakistan rely on tariffs for more than 10 percent of their central government revenue. India relies on tariffs for more than 20 percent of its revenue. Sierra Leone gets nearly half of its revenue from tariffs.

There is a simple explanation for the fact that developing countries, and especially poorer developing countries, tend to be heavily dependent on tariff revenues to support their governments. It is relatively easy to tax goods that are brought into the country at a border crossing, port or airport. By comparison, most other types of taxes—income taxes, payroll taxes or sales taxes—require an extensive tax-

<table>
<thead>
<tr>
<th>TABLE 2: Tariffs As a Percent of Government Revenue</th>
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<tbody>
<tr>
<td><strong>Low and Middle Income Countries</strong></td>
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<tr>
<td>Algeria</td>
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<td>Argentina</td>
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<tr>
<td>Bolivia</td>
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<td>Brazil</td>
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<td>Chile</td>
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<td>China</td>
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<td>Colombia</td>
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<td>Egypt</td>
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<td>Indonesia</td>
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<td>Kenya</td>
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<tr>
<td>Mexico</td>
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<td>Pakistan</td>
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<tr>
<td>Peru</td>
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<tr>
<td>Russia</td>
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<tr>
<td>Sierra Leone</td>
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<tr>
<td>South Africa</td>
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<tr>
<td>Turkey</td>
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<td>Venezuela</td>
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<tr>
<td>Vietnam</td>
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<tr>
<td>Russia</td>
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<tr>
<td>Sierra Leone</td>
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<tr>
<td>South Africa</td>
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<tr>
<td>Turkey</td>
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<tr>
<td>Venezuela</td>
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<tr>
<td>Vietnam</td>
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<tr>
<td><strong>High Income Countries</strong></td>
</tr>
<tr>
<td>India</td>
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<tr>
<td>Indonesia</td>
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<tr>
<td>Kenya</td>
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<tr>
<td>Mexico</td>
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<tr>
<td>Pakistan</td>
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<tr>
<td>Peru</td>
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<tr>
<td>France</td>
</tr>
<tr>
<td>Germany</td>
</tr>
<tr>
<td>Japan</td>
</tr>
<tr>
<td>United Kingdom</td>
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<tr>
<td>United States</td>
</tr>
</tbody>
</table>

* data for 1990

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collection system, including administration and enforcement, that can collect taxes from a large number of businesses, or an even larger number of individuals, scattered throughout the country. While industrialized countries generally have such systems in place, most developing countries do not. In countries that have poor transportation and communications systems, as well as serious problems with corruption, it can be even more difficult to devise an alternative to tariffs that can be as effective in raising revenue. In many cases, a tariff may actually be the most efficient form of tax, since an alternative form of taxation would be very expensive to administer and enforce. In these countries, switching from tariffs to other revenue sources would likely result in large economic losses.

By modeling a situation in which tariff revenue can be readily replaced with other sources of tax revenue that do not produce economic distortions, these modeling exercises seriously distort the reality faced by governments in developing countries. Reductions in tariff barriers will either force substantial cutbacks in public services or the creation of new or expanded taxing agencies. Both scenarios imply large costs that are ignored in these models.

The second issue, the adjustment process to a liberalized trading regime, raises issues that are at least as important as the problem of replacing lost tariff revenue. The economic projections from trade models often imply large shifts between industries. For example, in general these models will imply a large movement of workers out of agriculture in developing countries. They also will imply a loss of jobs in many domestic industries that will not be able to compete internationally in the absence of protection. In the models, these workers find new employment in the sectors that expand as a result of trade liberalization.

This may be an accurate description of a long-run process that happens over decades, but it does not fit neatly with the way economies work over relatively shorter periods, such as an individual’s working lifetime. Major economic transformations—such as the transition from an agricultural economy to an industrialized economy—are usually enormously painful processes in which large parts of the
population are subjected to long periods of unemployment and financial insecurity. People do not generally leap at the opportunity to leave communities that have provided homes for their families for generations. While often the shift to cities is voluntary, in many cases it is an act of desperation, undertaken when it is no longer possible to support a family in the countryside.

In 1870, 53 percent of the United States labor force worked in agriculture, a percentage comparable to what would be found in many developing countries today. By 1970, a hundred years later, the share of the labor force working in agriculture had fallen to 4.6 percent, a level comparable to most industrialized countries at present. Despite the fact that this transition took place over 100 years, it nevertheless led to severe social disruptions, prompting the growth of radical populist movements.

In many countries, the implications of these modeling exercises are that comparable transitions are accomplished in the span of one or two decades. The implicit economic logic in these models is that the reduction of agricultural prices to world levels will make it impossible for large portions of the rural population to remain employed in agriculture. These workers will then move to the cities in search of employment. Since the models assume that labor is fully employed, the possibility that workers displaced from agriculture could remain unemployed for long periods of time is ruled out by assumption.

Table 3 shows the percentage of the employed in agriculture for several representative developing countries. Economic models, such as the ones constructed by the World Bank or BDS, don’t allow for precise projections of the extent to which the rural population will be displaced as a result of trade liberalization. But countries such as China and Indonesia that currently have a very high percentage of their population living in rural areas, and protect their farmers with high tariff barriers, are likely to experience a very rapid pace of displacement if trade liberalization advances as quickly as is assumed in the simulations modeled by the World Bank or BDS.
It is worth noting that it is not just the agricultural sector in developing countries that is likely to experience displacement. In many cases, domestic businesses are likely to fail, once they no longer can rely on tariff barriers to protect them from international competition. In principle, this can be desirable because it is exactly this movement of labor and capital from less efficient to more efficient businesses that is the basis of the projected gains from trade.

However, a key assumption in this scenario, as noted earlier, is that the displaced workers become re-employed. If the transition moves too rapidly, it is likely that many workers will experience substantial spells of unemployment. And if unemployment becomes too widespread from displacement in both agriculture and domestic industry, it could lead to social instability, which may undermine the conditions neces-

<table>
<thead>
<tr>
<th>Country</th>
<th>Percent of Women Employed in Agriculture</th>
<th>Percent of Men Employed in Agriculture</th>
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<tbody>
<tr>
<td>Bangladesh</td>
<td>78</td>
<td>54</td>
</tr>
<tr>
<td>Bolivia</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Brazil</td>
<td>22</td>
<td>28</td>
</tr>
<tr>
<td>Chile</td>
<td>4</td>
<td>19</td>
</tr>
<tr>
<td>China*</td>
<td>47</td>
<td>47</td>
</tr>
<tr>
<td>Egypt</td>
<td>42</td>
<td>32</td>
</tr>
<tr>
<td>Indonesia</td>
<td>42</td>
<td>41</td>
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<tr>
<td>Malaysia</td>
<td>14</td>
<td>19</td>
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<tr>
<td>Mexico</td>
<td>13</td>
<td>30</td>
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<tr>
<td>Pakistan</td>
<td>67</td>
<td>44</td>
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<tr>
<td>Peru</td>
<td>5</td>
<td>10</td>
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<tr>
<td>Turkey</td>
<td>65</td>
<td>30</td>
</tr>
<tr>
<td>Venezuela</td>
<td>2</td>
<td>19</td>
</tr>
<tr>
<td>Vietnam</td>
<td>71</td>
<td>70</td>
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</tbody>
</table>

*percentage refers to share of the entire labor force employed in agriculture, not divided by gender.
sary for renewed economic growth. If liberalization policies cause enough displacement to generate serious social instability, the displaced workers may have to wait a very long time to be re-employed elsewhere, since the necessary investment will not be forthcoming. In this scenario, liberalization will have shifted workers from being employed in inefficient industries to being altogether unemployed—creating an obvious loss for these workers, and for the economy as a whole.

It is important to recognize that large-scale and enduring unemployment is the rule, rather than the exception in the developing world. Table 4 gives estimates from the International Labor Organization of the unemployment rate for several developing countries at the end of the nineties.\textsuperscript{10} As long as there is widespread unemployment in a country, an

<table>
<thead>
<tr>
<th>% Unemployment (1999)</th>
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<tbody>
<tr>
<td>Argentina</td>
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<td>Bolivia</td>
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<td>Venezuela</td>
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Source: World Development Indicators 2001; United Nations Development Programme 2001; and ILO Online Database
*data for 1998
emphasis on shutting down inefficient industries may be misplaced. Implicitly (and often explicitly), the assumption of advocates of liberalization is that foreign direct investment will naturally move in to take advantage of large pools of unemployed labor. In fact, there is no guarantee that such flows will occur or that the flows will be large enough to prevent whole generations of workers from being unemployed or underemployed for most of their working lifetime.

V. LOSSES FROM TRADE AGREEMENTS

It is important to recognize that some aspects of the trade liberalization being promoted by the World Bank and others will necessarily lead to significant losses for developing countries. Specifically, developing countries will incur sizable costs from licensing fees and royalties that result from having to adopt U.S.-style rules on patents and copyrights. They are also likely to incur significant costs from holding reserve currencies—assets that provide very low returns—in order to maintain the stability of their currencies in a volatile international financial system. Economists have not devoted much energy to quantifying these costs, but the existing evidence indicates that they are likely to be substantial. This section will briefly describe the nature of these costs and examine evidence as to their size.

Recent trade agreements, most notably the Trade Related Aspects of Intellectual Property (TRIPS) provisions of the Uruguay Round WTO agreement, require developing countries to adopt U.S.-style patent and copyright laws.11 This will allow foreign corporations to get patents and copyrights that apply to the sale of items such as prescription drugs, computer software, recorded music and videos and many other items. As a result of this protection, consumers and businesses in developing countries will pay far more for these items than they would cost without such protection. The higher prices constitute costs both because they will directly transfer money from developing countries to the industrialized countries and because they will lead to large distortions in the market as a result of raising the price of protected goods far above the cost of production (the latter are referred to as “deadweight losses” in the economics literature).
It is important to recognize the order of magnitude of the distortions created by these forms of protection. It is unusual for trade barriers to add more than 20 percent to the price of a product in the industrialized countries or more than 40 percent in developing countries. In contrast, patents, at least in the case of prescription drugs, typically add 300-400 percent or more to the price of the product (Baker, 2002). In the case of software or recorded music and video material, items that could otherwise be transferred at almost zero cost over the Internet, the protected products can instead be sold at a significant price—sometimes hundreds of dollars for software or $10-$30 for recorded music and videos.

Obviously, there is a rationale for the protection provided by patents and copyrights. The profits earned by holders of patents and copyrights provide an incentive to undertake research and/or creative activity. But apart from the issue of whether patents and copyrights are the best way to provide this incentive, there is a separate issue faced by developing countries. The amount of technology and creative work that is produced is not likely to be significantly affected in the foreseeable future by the decision by developing countries to introduce and enforce patent and copyright laws. Yet the enforcement of these laws will drastically raise the prices of what they consume. While it might be argued that in the long run the developing countries will benefit from having strong patent and copyright laws, it is not even possible to make this assessment without first knowing what their cost is likely to be. At present, the evidence on the size of these costs is extremely limited.

The World Bank recently attempted to quantify some of the costs of TRIPS. The first column in Table 5 shows its estimates of the net change in patent rents that several developed and developing countries would pay as a result of TRIPS. In several cases, the net outflow of funds is quite large, most notably in South Korea, where the World Bank estimated the size of the net outflow at 3.4 percent of GDP. While the estimates for the other countries are considerably smaller, this projection for South Korea is worth noting. Presumably, the main reason that the projected costs would be so large in the case of South Korea is that it is a comparatively wealthy developing nation. The other coun-
tries shown in the table are all considerably poorer. An implication of this pattern is that TRIPS will become considerably more costly to developing countries as they grow richer. Therefore, while patent fees may present only a limited burden to these countries at present, they will become a much greater drain on countries’ resources and pose more of an obstacle to development as they get wealthier.

<table>
<thead>
<tr>
<th>TABLE 5: The Cost of TRIPS</th>
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<td>Brazil</td>
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<td>China</td>
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<td>Greece</td>
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<tr>
<td>India</td>
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<td>Korea</td>
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<td>Mexico</td>
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<td>Portugal</td>
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<td>South Africa</td>
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<td>Spain</td>
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</table>

But the patent rents significantly understate the actual costs of patents and copyrights to developing countries. These projections only count the direct outflow of patent rents from developing countries to other countries. This is only a portion of the total cost. In addition to the money directly transferred out of the country, there will also be substantial economic distortions due to the fact this protection causes goods to sell at prices far above their marginal costs. The size of these losses will depend on the percentage increase in price that it is assumed results from patent or copyright protection, and also the elasticity of the demand for the products in question. Since the percentage increase in price is likely to be very large (often more than several hundred percent), the efficiency losses are likely to be quite large as well. A recent study found that
these deadweight losses were on average twice the size of the estimated patent rents (McCallum, 1999, Tables 6 and 8). Column 2 shows the total cost under the assumption that efficiency losses from patent protection are twice the size of the direct outflow of patent rents.15

Column 3 of Table 5 combines the losses directly attributable to patent rents with the deadweight losses. These total losses are quite large relative to gains that the World Bank estimated for developing countries from trade liberalization. In the case of South Korea, the estimated loss of 10.1 percent of GDP is several times larger than what the country could reasonably hope to gain from trade liberalization. In China, the estimated losses are equal to 1.4 percent of GDP and in Brazil, 2.4 percent of GDP, respectively.

Even this estimate ignores many of the costs associated with the enforcement of patents and copyrights. The table shows only the losses that result from the higher prices charged to consumers for patented and copyrighted materials; it does not include either the costs associated with rent seeking behavior or the enforcement costs incurred by the government. The former costs would include copycat research efforts induced by monopoly profits for patent holders as well as bribes and legal fees associated with the preservation and enforcement of copyrights. Insofar as these fees are paid by foreign corporations, they are not a loss to economies of developing countries, but to some extent domestic corporations are likely to be brought into this process as well. The enforcement costs to governments include the creation of agencies that can evaluate and approve copyright and patent applications (with some patent applications taking up hundreds of thousands of pages, this is not a trivial task) and also preventing the distribution of unauthorized copies of copyrighted or patented material. Since technology has made the spread of unauthorized versions of some items (especially digital material) very easy, and the savings from using them are very large, economic theory would suggest that government enforcement efforts will be very expensive.

It is also important to note that these estimates refer only to static losses. There are likely to be significant dynamic costs associated with enforcing patent and copyright protection in developing countries.
The transfers of patent rents and inefficiencies resulting from patent and copyright enforcement will reduce GDP and therefore savings and growth in developing countries. This effect will be amplified by the fact that patent and copyright enforcement is likely to have an especially large effect on the price of investment goods, such as computers. A large percentage of the cost of a computer is attributable to the licensing fees that companies such as Microsoft charge for the software and technology in the computer. Therefore, the cost to developing countries of buying computers and other high-tech items will be far higher if they are forced to pay these fees, as opposed to a free market scenario in which there are no applicable patents or copyrights. These protections would therefore be expected to reduce investment and growth. In addition, insofar as there are economies of scale in certain industries, losses to developing countries will be multiplied as output is reduced. For these reasons, the estimates in Table 5 are likely to understate the actual costs of TRIPS to developing countries.

The second largely neglected source of costs to developing countries from the recent path of globalization is the increase in foreign reserve holdings. Throughout the developing world, countries have felt, over the last four decades, the need to vastly increase the size of their holdings of foreign reserves relative to GDP. These increases are easy to document. Table 6 shows the increase in the ratio of reserve holdings to GDP in the major regions of the developing world.

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<tbody>
<tr>
<td>East Asia and Pacific</td>
<td>12.2%</td>
<td>16.2%</td>
<td>19.4%</td>
<td>22.5%</td>
<td>24.6%</td>
</tr>
<tr>
<td>South Asia¹⁴</td>
<td>4.1%</td>
<td>6.3%</td>
<td>8.1%</td>
<td>8.4%</td>
<td>8.5%</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>5.0%</td>
<td>9.1%</td>
<td>8.9%</td>
<td>11.8%</td>
<td>13.2%</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>5.7%</td>
<td>7.6%</td>
<td>7.4%</td>
<td>11.7%</td>
<td>13.6%</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>10.9%</td>
<td>14.0%</td>
<td>24.2%</td>
<td>21.4%</td>
<td>20.1%</td>
</tr>
</tbody>
</table>


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¹⁴ South Asia includes Afghanistan, Bangladesh, Bhutan, India, and Pakistan.
There is no widely accepted explanation for this increase. Clearly, the fact that the ratio of trade to GDP has significantly increased over this period explains a portion of this increase. However, the magnitudes are too large for this to be the main explanation. The breakdown of the Bretton Woods system and the increase in financial instability in recent years have clearly played a role. It is worth noting that there has also been a large increase in the ratio of reserve holdings to GDP in the years since the East Asian financial crisis.

Whatever the exact cause, the increase in reserve holdings imposes a large burden on developing countries. Reserves are typically held in the form of gold, short-term debt of the United States and other major industrialized countries, or in bank deposits denominated in major international currencies and held in major money-center banks. In general, these holdings provide very little real return, generally less than 2.0 percent above the rate of inflation. But there is a very large opportunity cost to these reserves. Developing countries accumulate reserves by having an excess of domestic savings over domestic investment. If they did not have to hold this money as reserves, it could be invested domestically in physical or human capital. The real return on such investment in the industrialized countries is generally estimated at approximately 10 percent a year. In developing countries, the return to capital is generally believed to be far higher—20 percent a year or more. Therefore, the cost to the developing countries of holding reserves is the difference between the returns this money would earn if invested domestically in physical or human capital and the 0 to 2 percent real return it earns when held as reserves.

Table 7 shows the cost to the major regions of the developing world as a result of having to maintain their current ratio of reserves to GDP, as opposed to the ratios they held in the sixties. It assumes alternatively that the gap between the return on capital and the return from reserve holdings is 10 percentage points in the low-cost scenario and 20 percentage points in the high-cost scenario. The
cost in each region is substantial, with East Asia experiencing the
greatest costs, between 1.0 and 2.1 percent of annual GDP. This is a
substantial cost, associated with the path that globalization has taken
in the last three decades, which has been largely overlooked by
economists. This cost also is comparable in size to the potential gains
from trade liberalization that the World Bank estimates for the
developing countries.

| TABLE 7: Cost of Increased Reserve Holdings, 1960s to 1990s (Percent of GDP) |
|---------------------------------|-----------------|-----------------|-----------------|-----------------|
| REGION                          | Annual Cost     | Cumulative Cost– |
|                                 | Low Cost (10 years) | High Cost (10 years) | Low Cost (10 years) | High Cost (10 years) |
| East Asia and Pacific           | 1.0% 2.1%       | 11.8% 23.6%      |
| South Asia                      | 0.4% 0.9%       | 4.9% 9.9%        |
| Latin America and Caribbean     | 0.7% 1.4%       | 7.8% 15.6%       |
| Sub-Saharan Africa              | 0.7% 1.4%       | 4.6% 9.2%        |
| Middle East and North Africa    | 1.1% 2.1%       | 12.0% 24.1%      |


VI. CONCLUSION: WILL DEVELOPING COUNTRIES GET RICH FROM TRADE LIBERALIZATION?

This chapter has examined some of the evidence for claims that trade liberalization will significantly improve the plight of people in developing countries. As noted above, many of the claims frequently made about trade liberalization are not supported by the evidence. For example, one of the most respected trade models showed that most developing countries were actually harmed by the recent liberalization of trade barriers in agriculture and textiles. Furthermore, it pointed out that the World Bank’s own trade model showed that developing countries would gain far more from their own liberalization of trade barriers than liberalization by the industrialized countries. Therefore, assertions that developing countries are likely to experience large gains as a result of the removal of trade barriers by
the industrialized countries—especially in agriculture and textiles—are not supported by the evidence.

This chapter also called into question the general usefulness of these trade models in policy debates. It noted that the modeling of past policy changes has produced widely varying projections, as does the modeling of current proposals for trade liberalization. As is noted by the World Bank and others, efforts to incorporate less well-understood effects of trade liberalization, such as economies of scale, increased competition and the liberalization of trade in services are speculative and are not well grounded in evidence. As a result, the larger projections of gains from trade are highly speculative in nature.

This chapter also explored two of the important assumptions of standard trade models. First, these models assume that the tariff revenues lost as a result of trade liberalization are replaced by a fictitious revenue source—a non-distortionary lump sum tax. Since in the real world all taxes lead to some economic distortions, these projections overstate the actual gains from trade liberalization. This overstatement is especially serious in developing countries, where tariff revenue often accounts for more than 10 percent of government revenue and sometimes more than 30 percent. The loss of this revenue would require the creation of alternative tax-collection systems, which may prove far less effective at raising revenue and lead to more economic distortions than collecting tariffs on items crossing the border.

The second seriously problematic assumption in these trade models is that the resources displaced by the removal of trade barriers (e.g., the unemployed workers) can simply move to sectors that are expanding. In reality, this process can involve very long periods of adjustment. It can also lead to considerable social upheaval if it proceeds too quickly. In the United States, the movement from a rural to an urban society was a lengthy process that at several points sparked serious social unrest. It is unlikely that developing countries can avoid the same problems. Therefore, it is rea-
reasonable for them to opt to limit the pace at which workers are displaced from agriculture and other traditional sectors, in spite of the economic gains that trade models indicate will result from this displacement.

This chapter also noted two serious costs associated with the recent path of trade liberalization that have been largely overlooked in discussions of trade liberalization. The first set of costs results from the higher prices that developing countries will have to pay for many items as a result of enforcing U.S.-type patents and copyrights. (As noted earlier, this is actually the result of increased protectionism, since these measures interfere with a free market, but recent trade agreements, such as NAFTA or the Uruguay Round of the WTO, have generally included provisions requiring increased enforcement of patents and copyrights.) Since these patents and copyrights can raise the price of protected items by several hundred percent—or more—over the free market price, they can impose large economic burdens on developing countries and lead to large transfers from poor countries to rich ones.

The second source of costs to developing countries from the recent path of trade and capital account liberalization is the rise in foreign reserve holdings. Countries in every region of the developing world have substantially increased the ratio of their reserve holdings to GDP over the last three decades. Apparently they have viewed this as necessary to maintain the stability of their currencies in international financial markets. The costs from higher reserve holdings stem from the opportunity cost—reserve holdings offer real returns that are typically less than 2.0 percent annually. By contrast, if this money were invested in physical or human capital, the real return would typically be in the double digits, and in some cases would exceed 20 percent annually. By forcing developing countries to forego this higher return, the need for large reserve holdings places a substantial burden on developing countries.

Figure 7 compares the gains to developing countries from trade liberalization by rich countries as projected by the World Bank with
estimates of the costs associated with patent and copyright protection and the losses associated with increased reserve holdings. These projections can only give a general sense of the orders of magnitude involved. Not only do the projections cover different countries, they also apply to different time periods. For example, the costs attributed to increased reserve holdings reflect changes over the last three decades—not a projection for the future. Nonetheless, the chart can be viewed as providing a useful guide as to the best policy prospects for improving the economies of developing countries.

Figure 7: Change in GDP, Developing Countries, 2015, as a result of various policies

As the chart shows (see Appendix 1), the magnitude of the losses that developing countries have incurred as a result of the need to increase their holdings of foreign reserves, and the projected losses due to the implementation of the TRIPS agreement, are each comparable to the gains projected from future trade liberalization. A clear implication of this comparison is that the benefits to developing countries from addressing each of these two major causes of economic losses could be as large or larger than the gains from liberalizing trade. In other words, increasing the stability of the international financial system so that large reserve holdings are no longer necessary, or reversing the patent and copyright rules imposed in the TRIPS agreement, may benefit developing countries as much or more than achieving progress in liberalizing trade.

The authors would like to thank Debayani Kar, Simone Baribeau, and Andrea Blatchford for their comments, research and editorial assistance.
APPENDIX 1

Table 1
Column 1 in Table 1 shows the World Bank’s purchasing power parity estimates of per capita GDP for the countries listed. Column 2 projects the 2015 per capita GDP applying the baseline growth projections for 2001-2010 that appear in World Bank 2002, Table A3.2. The growth projections for a region (e.g., sub-Saharan Africa) were applied to each individual country in the region. The third column shows the projected per capita GDP assuming that the trade liberalization modeled in World Bank 2002, Table 6.1 (with exogenous productivity growth) occurs. This adds 0.11 percentage points to the annual growth rate. The fourth column projects 2015 GDP if the countries were able to maintain the 6.0 percent annual rate of per capita GDP growth achieved by South Korea between 1960 and 2000.

Figure 7
The gains from trade liberalization shown in Figure 7 are the estimates of the gains to developing countries from liberalization in the high-income countries which appear in World Bank 2002, Table 6.1 (with exogenous productivity growth). The loss to developing countries due to TRIPS is the average share of GDP loss among the developing countries that are included in Table 5. The figure is the total loss, combining the estimated rent transfer from World Bank 2002, Table 5.1, with the imputed deadweight loss shown in the second column of Table 5. The loss due to increased reserve holdings averages the high- and low-cost estimates in Table 7 (implying a net opportunity cost of 15 percent on money held as reserves), weighting the regions by GDP.

APPENDIX 2

Trade and Inequality: The World Bank vs. standard theory
One of the basic theoretical results of trade theory is that the factor of production (capital, skilled labor or unskilled labor) that is
relatively more abundant in a country opening up to trade than in the rest of the world will gain disproportionately from trade liberalization. This would imply that in a wealthy nation where capital is relatively abundant, like the United States, corporations should be proportionately the largest beneficiaries of trade liberalization. This is because their capital is in relatively scarce supply elsewhere in the world, and therefore can command a high return. By contrast, less-skilled workers in the United States would be expected to do relatively poorly. They will be placed in competition with large numbers of workers in developing countries (primarily through the shifting of factories), which would be expected to drive down their wages.

In the last two decades, there has been a significant increase in inequality in the United States, as the rate of return on capital has increased and the wages of more-skilled workers have risen at the expense of less-skilled workers. Most economists attribute part of the increase in inequality to the impact of increased trade (e.g., Kline, 1997; Krugman, 1995; Schmitt and Mishel, 1996). The range of estimates of the contribution of trade to inequality implies that large segments of the U.S. workforce were net losers from the increased trade of the last two decades.18

While there are significant differences in estimates of the size of the impact of trade, virtually all trade and labor economists accept that increased trade has played some role in increasing inequality between skilled and less-skilled workers, as well as contributing to a redistribution of income from labor to capital. Remarkably, the World Bank’s model does not show this effect. In every region of the world, labor does comparatively better than capital as a result of trade liberalization. Appendix Table 1 shows the ratio of the gains projected for labor relative to the gains projected to capital as a result of trade liberalization. The table includes the projections from BDS and also the United States International Trade Commission. While these modeling exercises do not simulate the exact same polices, it is worth noting that only the World Bank
finds that labor will, in general, achieve larger gains than capital in the industrialized countries.

### APPENDIX TABLE 1

<table>
<thead>
<tr>
<th>Ratio of Gains to Labor to Gains to Capital</th>
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<tr>
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<tr>
<td>All Labor</td>
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<tr>
<td>BDS 2001–Uruguay Round</td>
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<td>Japan</td>
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<tr>
<td>United States</td>
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<td>EU and EFTA</td>
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<td>BDS 2001, Millennium Round</td>
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<td>United States</td>
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<td>EU and EFTA</td>
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<tr>
<td>USITC 1999, Textile and Apparel</td>
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<td>United States</td>
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<td>World Bank 2000, Millennium Round</td>
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<td>United States</td>
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<td>EU and EFTA</td>
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### NOTES

1. It is actually inaccurate to characterize the imposition of U.S.-type patent and copyright laws as trade “liberalization.” Patents and copyrights are forms of protectionism—effectively a government-enforced monopoly.

2. It is not clear that the Council of Economic Advisors actually derived this projection from an economic model.

3. One implication of the assumption that has been incorporated into these models—that expanded trade increases productivity throughout the traded sector—is that countries would often benefit by subsidizing exports of certain products. This view would imply that trade liberalization may not maximize efficiency and growth.

4. More precisely, BDS estimate welfare losses, which are not identical to GDP losses. Effectively, these measures are the amount of money that each nation would need to make it as well off as if the trade liberalization had not taken place.

5. It is appropriate to compare per capita GDP growth rates to the incremental increases in growth projected to occur as a result of trade liberalization, since there is no rea-
son to expect that trade liberalization will have any direct effect on population growth. Therefore, any gains in growth would be translated directly into per capita GDP growth.

6. One issue that is very important in the trade debate is the impact of trade on inequality. There is considerable evidence that increased opening to trade has increased inequality, at least in the industrialized countries. (See Baker and Weisbrot, 2001.) The standard trade theory implies that capital and skilled labor in industrialized countries (the relatively scarce factors) will benefit disproportionately from trade liberalization, and that unskilled workers (more than 70 percent of the labor force in the U.S.) would fare relatively worse. (The opposite is implied for the developing countries.) The World Bank's model has the unusual result that unskilled workers, and skilled workers, seem to do better than capital just about everywhere. This issue is examined in more detail in Appendix 2.

7. These projections assume that the growth rates projected by the World Bank for the period 2001–2010 continue through 2015 (World Bank, 2001, Table A3.2).

8. The model used by the United States International Trade Commission to analyze the economic impacts of trade policy also makes the same assumption about replacing tariff revenue with lump sum taxes (see Baker and Weisbrot, 2001, and United States International Trade Commission, 1999).

9. This data can be found at http://www.usda.gov/history2/text3.htm.

10. Methods for measuring unemployment vary considerably across countries, and some of these figures (e.g., for Mexico) undoubtedly underestimate the actual number of unemployed.

11. The requirement is phased in, with the least developed countries not required to have these laws on their books until 2005, a date which was further delayed in the agreements reached in Doha last year.

12. In effect, without copyright and patent laws developing countries will be benefiting from the innovations and creative work of industrialized countries without being forced to pay for it, in the same way that the United States and most other currently industrialized countries benefited from the innovations and creative work of the countries that had preceded them in the industrialization process. Insofar as the fruits of knowledge cannot be contained, it is inevitable that individuals and countries will eventually be able to benefit from the work of others without having to pay for it directly.

13. It is worth noting that a portion of this projected increase is attributable to a projection that there will be more foreign direct investment, which will result in larger patent rents. The case that stronger enforcement of patents and copyrights will lead to more foreign direct investment is extremely dubious on logical grounds. If a country opts not to honor patents and copyrights, then any person from anywhere in the world would be able to evade foreign patents and copyrights on that country’s terri-
tory. A firm could not prevent such challenges to its property claims simply by opting not to invest in such countries. Unless it is assumed that firms use cartel-like behavior to punish countries that lack strong patent and copyright enforcement, there is no logical reason for believing that the volume of foreign direct investment would be related to patent and copyright enforcement.

14. It is possible that the figure for South Korea is inflated due to problems with the methodology used. This methodology seeks to estimate the transfers due to enhanced patent and copyright protection, based on the fees that firms pay to get and renew patents. This methodology would at best give very inexact estimates. It would completely miss payments borne by consumers that cover the cost of patent-associated rent-seeking behavior, such as advertising. In many cases, these costs will be quite large. For example, in the case of prescription drugs in the United States sales and promotion costs are probably larger than industry profits. This would mean that in general the methodology would understate the cost of TRIPS to developing countries.

15. To provide an example, an unauthorized version of a videotape or videocassette may sell for $1-$2. With copyright protection, the same product may sell for $20-$30, with the distributor perhaps collecting as much as $10 in royalties. If the elasticity of demand is 1, then the reduction in quantity demanded resulting from imposition of protection would be between 90 and 97 percent. This would imply that the lost consumer surplus would be between 8.1 and 48 times as large as the royalty payment. The static efficiency loss from patent protection may be larger in the case of consumer goods than in producer goods, but this example demonstrates that the assumption that these losses are equal to the size of the direct transfer of income, excluding the deadweight loss, is very conservative, and likely a large underestimate of the actual costs.

16. The data for South Asia excludes Bhutan and Maldives. Both were outliers with ratios of reserve holdings to GDP which are far above the average for the region.

17. Data for South Asia excludes Bhutan and Maldives.


REFERENCES


I. INTRODUCTION

Oxfam’s core mission has always been to address the issues of poverty and social injustice. From our earliest years, we have sought to go beyond providing people with seeds and tools to addressing systemic causes of poverty.

Over the past several years, we have increasingly been defining ourselves as a rights-based organization. Our approach is anchored in a commitment to securing human rights with a particular bias toward social and economic rights. In short, we believe that poverty is a consequence of the systemic exclusion of distinct social groups from the rights, resources and opportunities to achieve their fullest potential.

Social exclusion, structural barriers and similar terminology sound very exciting and seductive. But we believe that this is not simply a matter of changing vocabulary. Adopting this approach has changed the way we work and the problems that we work on.

The following sections explain why Oxfam decided to pursue a rights-based approach, how we implement this approach and the challenges inherent in the approach. The final section will describe

Raymond Offenheiser is President of Oxfam America.
the link between our rights-based approach and our work on international trade.

II. A BREAK FROM PAST MODELS

At Oxfam, our epiphany began with trying to understand the history of our field. The traditional development literature is dominated by efforts to identify the crucial missing goods, services or pieces of knowledge (e.g., seeds, roads, family-planning education) that poor people need. These are followed by debates about which delivery mechanisms (the state, the market, the private sector) can most efficiently deliver these absent inputs. In this “welfare” paradigm, poverty is defined as the absence of public goods, and the solution is to figure out just what is missing and how to get it to the right places at the right time. Providing this type of assistance is deemed a noble act; it is an act of charity.

Experience of the past 50 years has shown, however, that development assistance efforts that were shaped within this “welfare model” are not enough. While we can show some real achievements, almost two billion people still live in poverty and the gap between rich and poor continues to grow. This is not for lack of many, many smart people working very, very hard to solve the problem.

In our analysis, this approach failed because it ignores social relations and other structural causes that reproduce poverty. What are those systemic obstacles that are standing in the way of people’s ability to access opportunity and improve their own lives? From the very outset, the rights-based approach centers on structural barriers that impede communities from having rights, capabilities and the capacity to choose.

Viewed in this fashion, development is about assisting poor communities in overcoming obstacles, rather than about the endless pursuit of grant aid for social goods. It assumes that people have dignity, aspirations and ambition and that their initiative is being blocked and frustrated by persistent systemic challenges such as apartheid, biased lending policies and non-functioning state social service delivery systems. It assumes that they are the most likely to know what institution-
al obstacles are thwarting their aspirations and are capable of being actors in defining the best approaches for overcoming such obstacles. It is anchored in the reality of local context and the analysis of the structural barriers to opportunity particular to that place and time.

III. AN ANCHOR IN HUMAN RIGHTS

So how is a rights-based approach different? First, it begins by defining poverty as social exclusion. Instead of focusing on creating an inventory of public goods or services that must be provided and then seeking to fill the deficit via foreign aid, the rights-based approach focuses on trying to identify the critical exclusionary mechanisms. Our starting point in confronting poverty is to identify the social, economic or political barriers that prevent people from availing opportunities to lift themselves out of poverty. These structural barriers can be of many different sorts—apartheid, lending policies, armed conflicts, trade rules, for example.

The core characteristics and strengths of the rights-based approach can be summarized as follows:

- This approach is based on the belief that human beings’ inherent dignity entitles them to a core set of rights that cannot be given up or taken away.
- This approach provides a normative framework of obligations that has legal power to render governments accountable. (See speech by Mary Robinson at the World Summit in Johannesburg, August 28, 2002; also see her contribution to this volume.)
- This approach places human rights law at the center of development practice and provides the framework and content for mounting ethical challenges to conventional wisdom and understanding about development practice and human security.
- This approach may or may not use legal strategies or language, but is grounded in and gains legitimacy from the rights enshrined in international and national law (e.g., Universal Declaration of

- This approach presumes to empower communities and individuals to know and claim their rights.
- This approach identifies those responsible for respecting, protecting and fulfilling human rights and holds them accountable for their responsibilities. Traditionally, respect and protection of human rights were the domain of human rights organizations, which focused on civil and political rights, while fulfillment was the domain of development organizations, which focused on economic, social and cultural rights. The rights-based approach aims at breaking these artificial cleavages and reuniting the core elements of the UN Charter.
- This approach recognizes the multilevel nature of rights violations and obligations and the need to address them systematically and strategically. In other words, violations and obligations exist at the local, national, regional and global level. At the same time, violations of civil, political, economic, social and cultural rights are often intertwined.

IV. PUTTING THE THEORY INTO PRACTICE

After accepting that a rights-based approach was a compelling way to think about development programming, Oxfam faced daunting questions about how to apply it in ways that make it useful conceptually, strategically and tactically. The organization had to rethink its design of program planning and the staffing requirements for implementing new types of activities.

As the first step in our new approach to program planning, Oxfam asks: Which rights are being violated? How are the poor excluded? What is most strategic? Guiding this work are five aims that Oxfam seeks to achieve:

- the right to sustainable livelihoods and secure employment, e.g., access to inputs, credit, markets, resources, fair wage;
• the right to basic social services (health and education), e.g., access to affordable medicines;
• the right to life and security;
• the right to be heard;
• the right to an identity (gender and culture).

The next steps in program design are to:

• identify the duty-bearers or advocacy targets (often the state, but increasingly corporations and international institutions);
• identify the points of entry for national civil society (what is the advocacy strategy; who are the allies and stakeholders);
• identify the needs of national civil society (e.g., grassroots mobilization, alliance building, research, access to media, access to advocacy targets);
• identify the best ways in which a support organization like Oxfam can meet those needs (e.g., grants, training, creation of networking opportunities, campaigning in the U.S., supporting or complementing national campaigns).

V. THE CHALLENGES OF IMPLEMENTING THE RIGHTS-BASED APPROACH

Complex issues of theory and practice arise in efforts to apply the rights–based approach. The first of these is the historical favoritism of civil and political rights in the traditional human rights field. This has created a hierarchy of rights which makes it difficult for organizations focused on economic, social and cultural issues, or even development organizations working on human rights, to gain legitimacy within the human rights sector. In looking at these questions in terms of the human experience, however, we can ask whether there is a hierarchy between the right to food and the right to life. Are these two categories of rights really dissociable?

A second issue is defining the content of rights. Human rights in general—and economic, social, and cultural rights in particular—have been historically difficult to define because some of the defining requires setting standards that are assumed to be context specific. This,
however, has not prevented the UN Committee on Economic Social and Cultural Rights, with participation from civil society and NGO groups, from defining the content of rights. The right to an adequate standard of living, for example, contains certain specific elements such as food, which in turn contains specific elements such as availability and adequacy.

A third issue is the nature of obligation that is incurred in the human rights regime. Entitlement, especially on American ears, is a dirty word. As a result, the reaction toward economic, social and cultural rights is often a negative one, as people understand entitlements to mean that governments will pull out the silver platter and feed, dress and house everyone.

A fourth issue is the extent to which human rights are universal or relative to a particular culture or context. This raises complicated questions for a development organization. What should we do when different rights clash (e.g., universal principles versus indigenous principles on gender rights and participation)? How should we deal with divergences between universal norms and local practice?

A fifth issue is that the enforcement mechanisms for economic and social rights are not as widely known as those for civil and political rights, nor are they as widely used. There is a widespread believe that economic, social and cultural rights are not justiciable. These rights will become more justiciable when more groups and NGOs make use of the laws and administrative systems that are in place, however imperfect they might be. More relevant still is the fact that enforcement of economic, social and cultural rights does not have to happen through court systems. NGOs can work with state officials and empower them, which may lead to a more collaborative relationship for the benefit of communities as well as the state.

A sixth issue is the relative responsibilities of states and non-state actors. Important questions here are: (a) given that under international law states are the primary duty-bearers, how do we interpret the duty of the international community to support individual states? And (b) given that under international law states are the primary duty-bearers, how do we interpret corporate social responsibility?
There are two views about this second issue. The traditional perspective is a narrow view: Corporations are obliged to respect the rights of their employees. A newer, broader view holds that corporations are obliged to protect the rights of workers throughout their supply chains.

A final issue is how to operate in countries with no political space for human rights. One strategy that has worked has been to try to build space from within the international community and apply pressure as circumstances allow. This approach has been somewhat successful in drawing attention to issues such as child labor in some Asian nations.

VI. RIGHTS AND TRADE

So how did Oxfam get from accepting that a rights-based approach is a compelling way to think about development programming to a global campaign to make trade fair? The answer is that it took a couple of steps.

In the early 1990s, we realized that many exclusionary barriers are found not at the local level where we have traditionally worked, but rather, at the national or global level. Our first major global campaign—carried out by all Oxfam affiliates in North America, Europe and East Asia—focused on education. Our goal was to build global support for achieving the UN goals of putting all children in school by 2015. We linked this initiative to the broader Jubilee Movement asking for debt relief. Our rationale for taking forward such a global campaign was the recognition that much of international development work had become reduced to creating islands of progress in a sea of misery and injustice.

As our partner organizations in the South would consistently demonstrate to us, their governments were collapsing under mountains of debt, and were unable to provide even the most basic social services of basic education and health to their populations. The Jubilee campaign achieved a partial success, forcing the G7—the club of the seven wealthiest countries—to adopt a debt-relief program that, while not the perfect solution, has acknowledged the injustice of the debt and set in motion a process for relieving it.
As Oxfam continued to press for a global initiative on education, a Global Movement for Social Justice was born on the streets of Seattle. Suddenly, the contradictions and hypocrisies of the global trading system were on display for the whole world to see. In an effort to build on the momentum of this public debate, Oxfam made a decision to join that movement and launch a global campaign on trade. It was our belief that, along with impacts of debt, international trade rules represent a major systemic barrier on a global level to the alleviation of poverty. It was our hope that we could play a modest role in bringing the voices of our southern partner organizations to the decision-making fora where the rules of this global trading system are drawn up and negotiated.

In this age of global systems of production, international trade directly affects millions of poor people. From Vietnamese rice growers to textile workers of Mauritius, from Ugandan produce growers to workers of the Indian software industry, millions of poor people draw their livelihoods either directly or indirectly from international trade. In most cases, eliminating such trade links would not help them. Despite appalling working conditions and extremely low wages, even our partners in the garment industry of Bangladesh reject the idea of withdrawing from export markets, for they understand very clearly that their alternatives in their villages may be bleaker still. So Oxfam determined for itself that trade can be good for the poor.

But that does not mean that we should turn a blind eye to grossly imbalanced trade relations and appalling working conditions and enthusiastically celebrate the virtues of free trade and globalization. Rather, it is Oxfam’s contention that trade does offer opportunities for poor people to earn higher incomes than they otherwise would, but that this promise is being squandered. The rules governing the world trading system are rigged in favor of the richest nations and against the poorest. And until the double standards, gross inequities and market distortions that flow from these rigged rules are addressed, we will never have a level playing field, and the potential of trade will not be fulfilled.
Oxfam has therefore embarked on an ambitious advocacy campaign that seeks to highlight those trade rules that are most hurtful to the poor. And rather than simply condemn current practice, Oxfam proposes alternatives that might serve as the basis of a more equitable trading regime. You can find any information about these campaigns and all of our trade work at www.maketradefair.com.

VII. CONCLUSION
At Oxfam we have made the transition to a rights-based approach because we believe in the first instance:

- that traditional approaches to development have been failing;
- that we have been faking it in terms of resource commitments;
- that the conventional wisdom of the Washington Consensus and free trade is morally bankrupt and a misrepresentation of social reality as we know it on the ground.

By contrast, we feel that the rights-based approach:

- is morally compelling;
- carries with it a sense of urgency;
- assumes that citizens have a role to play in defining their destiny;
- assumes that states have a role to play in being responsive to their citizens;
- is honest about the politics of the development process;
- raises serious questions about the viability of national social contracts and the shortcomings of global governance approaches (e.g., the WTO) in guaranteeing rights;
- is unifying of civil society movements around the world;
- creates real challenges for both state and non-state actors.

For Oxfam, this is not a passing fad. It is a strong philosophical position that we are translating into action and that will mark our organization for decades to come. And we hope that it will shape the broader development discourse for decades to come.
We deeply believe that he who defines the terms of the debate, defines the direction the debate will take. For too long, we have allowed a handful of institutions dominated by narrow self-interest to define the debate on behalf of the poor. We need to take the moral high ground back from the high priests of free market economics and put people back into the center of the discussion about social justice. Our belief is that the rights discourse and the rights-based approach will create the social power and sharpness of analysis to enable us to do that.
This volume emerges from the first annual International Forum for Development (IFD), held in New York City on October 17-19, 2004. Amidst growing dissatisfaction with development strategies that have failed to produce adequate rates of growth or to distribute resources equitably, the IFD brought together a diverse group of intellectuals to exchange ideas, to consider the contours of alternative policies and to work toward articulating a more equitable development project. Academics, activists, NGO leaders, policymakers and UN officials were among those who took part in the discussions, which were framed by a series of concept papers and panel presentations. This volume brings together a selection of those interventions, revised in an effort to convey to a broader audience the central points raised during two days of productive interaction. While the first International Forum for Development was a modest effort, it was a vital step in the creation of an alternative vision for development where, as co-chairs Ha-Joon Chang and Deepak Nayyar put it, “the focus is on people rather than economies, and on ends rather than means.”

—from the Preface