

Revisiting Trade and Development
Levelling the Playing-fields and Some More

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Received wisdom is that free trade, or something close to it, is the best strategy for developing countries to pursue. Over the last two decades, in particular, key international financial institutions, industrial-country donor agencies, Western think-tanks, and academic bodies have urged them to dismantle trade barriers and open up their economies to world commerce. Leaving aside the North's self-interest, this pressure arises out of a particular view of the functioning of the market economy, the basis of international trade, and the determinants of economic growth. This paper questions this view and argues for caution in the opening up of developing economies and their closer integration with the world economy.

Openness is not an absolute, and no economy can be deemed to be totally open or free. The industrial countries, which relied on protection to promote industry and continue to retain significant trade barriers, are not loath to apply protectionist measures whenever their national interest is at stake. Ultimately, each country has to decide for itself on the speed and extent of its integration into the global economy, taking account of its historical experience, stage of development, and economic circumstances. The issue for the developing countries is not simply one of shifting from protection to free trade, or from dirigism to laissez-faire, but one of designing their policies in the light of their national goals and aspirations and ability to compete and take advantage of the world market.

Developing countries suffer from a variety of handicaps that do not permit them to compete with the more powerful, industrial economies on equal terms in the world market. It is commonplace to liken competing in the world market to participating in a world sporting event. Both require satisfaction of three important conditions: the rules by which the game is played must be accepted and understood by all parties concerned; there must be a neutral umpire to ensure adherence to rules and

to adjudicate in areas of dispute; and players must be prepared for the event. On each of these counts, the developing countries are at a disadvantage: the rules seem to be more favourable to the principal rule-makers, i.e., the industrial North; the umpire—the triumvirate of the World Trade Organisation (WTO), IMF, and the World Bank—operates under the constraints of the biased rules and the lopsided decision-making processes of the three institutions; and the preparedness to compete in the world market varies enormously across the countries of the South. In short, the playing-field of world commerce is tilted in favour of the industrial nations and, in a situation where competitors of widely differing strengths are pitched against each other, the benefits from international trade that the theory promises are unlikely to materialise. This is an environment where the strong economies tend to get stronger, and the weak, weaker.

The case for free trade rests basically on two premises: that exploiting a country's comparative advantage improves resource use and the competitive pressure in the world market ensures that producers constantly improve their products and production processes. The first two sections of the paper examine the extent to which these propositions hold in reality. In the first section, the trade-and-development nexus is revisited, drawing attention to the critically important role technology plays in competitiveness and economies' ability to grow and develop. Creation of competitive strength in new and dynamic fields of economic activity is the challenge all economies face. In the second section, the nature of the world competition is discussed, first by focusing on the WTO rules and the North's protectionist policies and, then, by exploring the implications of the recent spate of mergers and acquisitions (M&As) for the industrial development of the South. This is followed, in Section 3, by a discussion of what may be done to prepare countries for competing in the world market, with a focus on the important role trade policy can play in promoting national development. Taking note of the deficiencies in the functioning of the world market, Section 4 identifies a few areas where action could improve the competitive environment for the developing countries and create more favourable conditions for sustainable economic growth. The final section summarises the paper's main conclusions.

1. Trade and Development Nexus

Trade and economic development from the very inception of the relatively new discipline of development economics have been intimately linked. There are several reasons for this. Commerce had been pivotal to the relationship of the South to the North during the colonial period. The colonies provided the critical raw materials as well as the markets to sustain the industrial development of the colonisers. To break or readapt the traditional commercial links and to forge new directions for international trade were goals that virtually all developing countries set for themselves. Crucial to this transformation was the reduction of dependence on primary exports and laying the foundations for industrial development. How this was to be achieved became the core of development economics.

In the earlier decades of development, it was generally recognised that developing countries needed active government involvement and public sector investments to bring about the required structural transformation.¹ The private sector could not be expected by itself to launch industrialisation, for it lacked both the means and entrepreneurial drive to do this. There was also a need to coordinate investment decisions in order to better use the scarce capital and foreign exchange. Since a principal goal of public policy was to reduce the dependence on traditional exports (for which the prospects were believed to be generally bleak) and create local manufacturing capacity, import-substitution through protection became a key strategy. This view of economic development had more or less universal appeal during the 1950s and 1960s, and continued to enjoy widespread support right up to the start of the 1980s despite mounting criticism.

There has occurred a sea-change since. State control and government regulation has yielded to privatisation, deregulation, and market liberalisation. Protectionism and the import-substitution strategy have fallen into disfavour, even in countries that were erstwhile its staunchest adherents, while “outward orientation” and export promotion have become the pillars of the new orthodoxy. Even where

¹ The current use of the term “structural adjustment” to characterise market liberalisation programmes is rather ironic since it was originally economists, sceptical of the market, who came to be called “structuralists”.

import-substitution is deemed desirable, qualifiers or euphemisms—such as “efficient import substitution” or “import replacement”—are used to describe the situation.

The Basis of Market Fundamentalism

The analytical underpinnings of the market fundamentalism are provided by the neoclassical economic framework, which rests on assumptions that are hard to satisfy in reality, especially as far as the developing countries are concerned. The traditional explanation of international trade has been provided by the doctrine of comparative advantage, according to which the pattern of international specialisation and trade depends simply on the relative costs of producing alternative outputs. The absolute costs of production (i.e., the amount of inputs used to produce one unit of output) play no role at all. Relative costs of production in turn depend exclusively on a country’s factor endowments since products requiring intensive use of the abundant factor would tend to be relatively cheaper than those that use intensively the scarce factor.

The deficiencies and limitations of the doctrine of comparative advantage have been widely discussed, but it has continued to enjoy exceptionally powerful influence on economic policy at domestic and international level. As Paul Krugman (1987) puts it:

“For one hundred seventy years, the appreciation that international trade benefits a country whether it is “fair” or not has been one of the touchstones of professionalism in economics. Comparative advantage is not just an idea both simple and profound; it is an idea that conflicts directly with both stubborn popular prejudices and powerful interests. This combination makes the defense of free trade as close to a sacred tenet as any idea in economics.” (p. 131)

One reason for the continuing popularity of the doctrine is that it gives a message of hope and optimism: free trade brings about efficiency and general prosperity all around. Specialisation on the basis of comparative advantage is inherently efficient, and engaging in international trade of mutual benefit to all

countries, especially when no single country can influence world prices. Under free trade, the terms of trade can never be unfair, countries cannot exploit each other economically, and there cannot be immiserisation of a country arising out of its openness. On the basis of its factor endowments and technological knowledge that all countries share equally, each country can find at least something that it can produce relatively efficiently and sell successfully in the world market and thereby enhance its income.

No less powerful is the conclusion that international trade can bring about convergence of living standards across countries without requiring capital and labour to move internationally in search of higher rewards. This occurs because international trade, under certain specified conditions, tends to raise the price of the relatively abundant factor while lowering it for the relatively scarce. The logic of this conclusion is appealing for its simplicity. International trade increases the earnings of the abundant factor as production shifts towards products where it is more intensively used. Thus, in developing countries, which are generally labour-abundant, the rise of labour-intensive exports can be expected to increase employment as well as wages. The opposite should happen in the labour-scarce country. Government intervention, therefore, is not only unnecessary but potentially harmful if it causes production to shift away from the country's comparative advantage. These conclusions are not just theoretical; they have been extensively employed in policy discussions and guided much of the recent empirical work on the impact of international trade on factor rewards. (See, for example, Wood 1995 and Freeman 1995)

The assumption of given factor endowments and widely shared technology is clearly untenable in a setting of economic growth, which results from, among other things, the accumulation of physical and human capital as well as build-up of technological capabilities. It has, therefore, been particularly difficult to explain the phenomenal growth and competitiveness of Japan and other East Asian economies in terms of the traditional model. These countries grew rapidly over a long period of time, and they did so by dramatically and systematically altering their productive structures and creating competitive advantages in new industries. The success of the new producers in penetrating the world market contributed to the displacement of the established patterns of trade specialisation. Remarkably, the success, which some

have tried to show as “market conforming” (World Bank 1991), could not have been predicted simply on the basis of the countries’ factor endowments at the start of the rapid development phase. Indeed, the economic (and political) outlook of some of these economies around the early 1960s was generally held to be extremely bleak. The consensus now is that the so-called East Asian economic miracle, far from being an outcome of free trade, was brought about by all manner of policy interventions.

In short, the doctrine of comparative advantage, while it may have some value in explaining existing international trading patterns, is inadequate in providing insights into the basis of economic transformation that has been the hallmark of growing economies over the last two centuries. The creation of new areas of competitiveness (or comparative advantage) and improvements in productive efficiency over time are the crux of the trade-and-development nexus and are crucially dependent on the build-up of a country’s technological prowess.

Numerous attempts have been made to incorporate technological change and knowledge generation within the neoclassical framework, but the models remain highly theoretical and by and large divorced from reality. They provide few insights for the developing countries. The celebrated work of Grossman and Helpman (1991) on innovation and economic growth in a globalised world, for example, puts forward the view that only countries with a “comparative advantage” in R&D should undertake it. In other words, the developing countries would be wasting resources in case they subsidise knowledge accumulation. Their advice to developing countries is: “Generally, when one country subsidizes R&D, this reduces the profitability of innovation abroad. If research contracts in a country [read: an industrial country] with comparative advantage in this activity, there may be a slowing of aggregate (world) innovation. In the event the policy may reduce welfare levels worldwide.” (p. 340) That this misses the essential nature of knowledge accumulation and technological progress will become clearer later.

Trade and Technology Interaction

The opportunities that international trade opens up for a country are fundamentally analogous to technological advance: they both raise an economy’s productive potential by making available goods that would otherwise either not be

available or be more expensive to produce. Indeed, a country's living standards can be raised either through an improvement in its terms of trade or through a rise in the productivity of its labour.² In both cases, more is obtained through a given expenditure of national resources. But there is one important difference. While the terms of trade improvement tends to be fortuitous, transitory, and largely beyond the control of any individual country³, productivity improvements result primarily from domestic efforts at seeking efficiency gains in existing productive activities and establishing new lines of production with higher value added and better prospects for growth.

Contrary to the doctrine of comparative advantage, a country's choice of specialisation is, therefore, a crucial determinant of a country's long term development and growth. Just as the lifetime income profile of a doctor differs considerably from a dock-worker, prospects of economic growth for individual economies depend on what they choose to specialise in. Using the example of Ricardo, the father of the comparative advantage doctrine, it does matter in real world as to who gets to produce wine and who produces textiles. Economies that are able to become competitive in rapidly growing, technological dynamic (not to be confused with hi-tech) sectors could be expected to have more favourable prospects for growth.

Another reason for the need for continuous technological upgrading is that the developing countries can take advantage of their low-cost labour only for a limited time since wages should rise as the economy grows. To preserve economic stability and competitiveness, labour productivity must rise at least as fast as wages, and this holds true in primary products as well as in sophisticated manufactures. Thus, for example, quick and high-yielding cocoa trees give Malaysia a competitive advantage over Ghana, despite considerably higher wages. Countries can compete on the basis of low wages or high productivity, but it is only the latter that would give them higher living standards over the long term. Continual technological upgrading, therefore, is crucial to competing and deriving gains from international trade.

² This is so because per capita income of a country is exactly equal to the level of output per employed person times the proportion employed in total population. A reduction in unemployment would, of course, help to increase income per capita, but this can go only so far as full employment.

³ There has been only one instance in recent history when a group of producing countries moved in concert to raise the price of their export, oil, in the 1970s. However, the subsequent decline in the oil price demonstrates that such actions can only be sustained for a relatively short period of time.

However, the relationship between trade and technology works in the opposite direction also: international trade provides stimulus for technological improvements and growth. The pressure foreign competition puts on domestic producers for productivity improvement was noted earlier and will be more closely examined in the next section. But foreign trade also facilitates the exchange of information on consumer wants and practices of other producers and helps to improve worker skills through giving access to imported capital goods embodying new technology. Competition in the world market exposes producers to new products and approaches and management styles, while buyer-seller contacts, which are the foundation of trade, stimulate improvements in products and processes. This aspect of international trade was noted by John Stuart Mill more than a hundred years ago:

“It is hardly possible to overrate the value in the present low state of human improvement, of placing human beings in contact with person dissimilar to themselves, and with which they are familiar. Such communication has always been, particularly, in the present age, one of the primary sources of progress.” (Quoted in Dornbusch 1992, p. 75)

In short, competing in the world market requires that a country exploit its existing strengths (comparative advantage), while searching for new areas for the development of competence. Existing endowments of capital, labour, and human skills, etc. define what a country might successfully produce and trade in the world market at any given time, but this is not an adequate basis for long term economic growth. Capital accumulation and investment in education, research and technological upgrading inevitably change a country's comparative advantage and create new areas of competence. The success in economic development lies in turning this into a self-reinforcing process, a virtuous circle of rapid growth and technological dynamism. Technological growth enables a country to compete successfully in the world market, which in turn promotes technological improvements. There is evidence that rapid export growth encourages higher savings and investment, and, therefore, stimulates economic growth (UNCTAD 1996).⁴

⁴ This line of reasoning should be distinguished from the popular advocacy of export-oriented growth (also called “export fetishism”). The benefits of international trade noted here have to be captured by the country concerned through investment in physical capital and technological upgrading; they do not follow automatically from export activity.

There also exist self-reinforcing links between the accumulation of human and physical capital and technological progress. As Nelson (1981) observed: “Just as a high rate of capital formation and well-educated work force stimulate technological advance, so technological advance stimulates a high rate of capital formation and motivates young people to acquire formal education”. (p. 1055)

Countries that have successfully broken into the virtuous circle—notably, the East Asian economies—have done so not by accepting the doctrine of comparative advantage at its face value, but rather by relying on both market signals and government interventions to further their development goals. Trade liberalisation, deregulation, and privatisation by themselves cannot be expected to deliver rapid growth, as has been the experience in much of the South over the last two decades. UNCTAD (1999) reports a general deceleration of economic growth in developing countries across the different regions of the world over the last two decades compared to the 1970s, despite trade reforms and other market opening measures.

2. World Competition and WTO Rules

The existence of competitive markets is a fundamental premise in mainstream economics, with profound implications for policy conclusions. Without it, much of the traditional trade theory would founder. It is the pressure of competition from rival producers that leads to the search for more efficient methods of production and better quality products. One of the key propositions of economics is that individual decision-making in perfectly competitive markets can yield outcomes for producers as well as consumers under which none can be made better off without making someone else worse off, a situation economists call “Pareto optimum”. This is obviously a rather generous notion of optimality, for there is hardly a policy decision in real life that benefits all without hurting anyone. If free competition helps an economy to arrive just at a Pareto optimal situation, this would be a rather shallow achievement, considering that there are bound to be winners and losers in any social transformation that occurs with economic growth and development.

But the degree and nature of competition itself differ widely across markets and countries. There are, first of all, few markets that come even close to the textbook case of perfect competition, where each buyer and seller is so insignificant that

it cannot influence market prices. Indeed, monopolistic or oligopolistic competition tends to be the rule, rather than an exception. Since the alleged benefits of the market system are based essentially on the perfect competition assumption, policy conclusions drawn from theory need careful qualification. There cannot be any certainty about outcomes when individual buyers and sellers, rather than taking markets prices as given, are in fact able to manipulate them to their advantage.

Then there are also different types of competition, as social psychologists point out (Kohn 1986; Lane 1991). Competition can, for example, be driven by rivalry (i.e., where the aim is somehow to defeat the rival) or it could be driven by goals (i.e., where the aim is to reach the goal regardless of how rivals perform).⁵ In its extreme form, the first type of competition is described as “cut-throat” or “dog-eat-dog” variety, where the goal of competing is in fact to end competition. Here a firm is preoccupied primarily with gaining control of the market, rather than improving productive efficiency or product quality. Although laws against this sort of behaviour exist, at least in the industrialised countries, predatory pricing is not an uncommon phenomenon (Baumol 1993). In this respect, the developing countries are particularly vulnerable for they usually have neither the laws nor the means for their adequate enforcement.

There are also significant differences in market systems, arising out of differences in legal and economic institutions as well as corporate governance and cultures. Attention in recent years has focused particularly on the peculiarities of the Japanese system as compared to the so-called Anglo-Saxon model of markets, which comes closest to economics textbooks. The close relationship between the government and businesses in the former has been widely discussed. It is also noted that the firm behaviour with respect to (say) hiring and firing of workers and inter-firm relations differ strikingly from the American market system. The hostile take-over activity that is common in the United States, for example, will probably be scorned as socially unacceptable in Japan. Thus, there are far fewer domestic rivals in such sectors as automobiles, electronics, consumer durables, etc. in the United States

⁵ The example from the world of sports of the first type of competition is wrestling and of the second, beating the clock to reach a certain distance, notwithstanding the kudos for doing it first.

than in Japan.⁶ Some observers (notably, Porter 1990) hold the intensity of domestic competition to have been a major factor in the Japanese success in the world market.

It is also often the case that collaboration and cooperation among economic agents yields outcomes that are socially superior to those of competitive markets. That competition entails considerable waste of resources is widely recognised. Thus, for example, when firms collaborate, they can reduce the cost of advertising, marketing, and research, etc., considerations that have evidently driven mergers and acquisitions. Even the U.S. government has not hesitated to foster cooperation among firms in pre-competitive generic research and encouraging mergers in defence-related industries. Limits on the number of producers to save on scarce resources and creating an environment for cooperation (for example, the promotion of agricultural and industrial cooperatives) can be helpful to growth at the early stages of economic development. Government-enforced mergers, planned exit of some producers from an activity, and cooperative arrangements in production and research were important means in the industrialisation experience of Japan, Korea, and other East Asian economies.

While the above qualifications have a bearing on the design of competition policy in individual countries, the focus here is on describing the “playing-field” of world commerce, which is influenced both by the functioning of the multilateral trading system and by the size of the firm and market concentration, an issue that has become prominent consequent to the recent spate of mergers and acquisitions (M&As) as a fallout of the globalisation phenomenon.

The Multilateral Trading System

World competition is obviously hobbled by trade barriers. To reduce these barriers has been the focus of a series of multilateral trade negotiations conducted within the framework of GATT over the last half century. Although considerable progress has been made in dismantling trade barriers, developing countries have benefited only to a limited extent and market access remains a prominent issue for

⁶ It may be argued that the number of domestic producers would not matter so long as they face competition from abroad. However, the rise in industrial concentration in such sectors as automobiles, electronics, and pharmaceuticals occurred in the United States during the 1950s, when imports were relatively insignificant.

them. The earlier rounds of multilateral trade negotiations did not address the two areas of major interest to the developing countries, viz., textiles and agriculture. Even under the Uruguay Round, which did cover the two issues, the progress to date has been at best modest.

Despite an expectation that developing countries should match industrial countries in their obligations to the multilateral trading system, developing country exports continue to face all manner of hurdles. These include asymmetry in import duties (i.e., many products of interest to developing countries face much higher tariffs), increasing use of contingency measures (anti-dumping and countervailing duties), agriculture protection and industrial subsidies. The continuation of the multi-fibre agreement (MFA) and agricultural protection in industrial countries leaves the developing countries at continuing disadvantage. Indeed, the common experience has been that whenever, and wherever, developing countries have succeeded in making significant inroads into industrial-country markets, they start to face a variety of non-tariff barriers; anti-dumping, voluntary export restraints (VERs), etc.

One reason for the general neglect of developing country interests in the existing multilateral framework is the reciprocal basis of trade negotiation: trade concessions are made on an exchange of offers. Since developing countries are generally poor and have not much to offer in terms of market access, they cannot expect to get a great deal in return. Given their large majority, the principle of consensus for arriving at decisions within the WTO could be expected to work in developing countries' favour. However, this too has proved to be of little help. For one thing, developing countries do not have complete convergence of interests, and therefore do not usually have a common platform on issues before the WTO. In fact, unlike the United Nations and its agencies, there is no formal grouping of developing countries (similar to G-77 or G-24) within the WTO. In practice, the search for consensus on multilateral trade issues often results in off-the-table deals between the major industrial countries and individual developing countries. There have also been reports (though not documented) that in situations of a deadlock in multilateral negotiations, governments of developing countries have come under pressure through means not directly related to trade (e.g., through a threat, actual or perceived, of withdrawal of foreign assistance).

It is sometimes suggested that developing countries could overcome the deficiencies in the multilateral trading system through a more active engagement in trade negotiations and pressing of demands to parallel industrial country proposals (the so-called “positive agenda”). It is, however, not clear what is meant by more active participation and what it would entail. The actual experience has been that developing country demands and proposals tend to be dismissed as unrealistic by the industrial countries. It seems, therefore, rather disingenuous for industrial countries to prod the South to produce a positive agenda. In any case, a major handicap that the developing countries face in coping with the multilateral trading system is that they lack the expertise and human resources to meet even the routine demands of trade negotiations, let alone deal with new subjects. Typically, a developing country representative has to be a jack-of-all-trades, with expertise ranging from human rights to electronic commerce, and little or no backing provided by the capitals.⁷

Apart from the continuing use of trade policy measures in industrial countries to protect their interests, there are several other areas that have direct and indirect effect on the nature of competition. First to be noted is the rise in corporate interest in trade negotiations. In the earlier years of GATT, the leading industrial nations were driven by broader objectives and were concerned with the creation of a world trading system that avoided the chaotic and self-defeating policies of the inter-war period, and were preoccupied with ensuring full-employment and equitable growth. This seems to have changed. The increasing preoccupation of trade negotiators with the so-called new issues—foreign investment, intellectual property, competition policy, to name a few—is basically the result of corporate pressure, which came to public attention most dramatically in the context of the failed negotiation on the Multilateral Agreement on Investment (or MAI). There has also been a pronounced increase in the involvement of industrial country governments in the promotion of their industries in bilateral commercial exchanges. When a major contract is won by a domestic firm, it is hailed as a national victory. It has become commonplace to see a secretary or minister of commerce on an overseas visit, disembarking from the aeroplane in the company of leading domestic CEOs.

⁷ This problem is widely appreciated, and various ideas have been put forward to deal with it. An interesting proposal has been made by a group of developing and industrialised countries for the establishment of an independent body of legal consultants, named “An Advisory Centre on WTO Law”. The South Centre’s WTO Pilot Project is also designed to alleviate the problem.

The exercise of influence on trade ministries to impose anti-dumping taxes or countervailing duties also appears to be on a rise in the industrial countries. Indeed, with the end of the Cold War, some governments have become quite open about the linkages between foreign policy and national commercial interests. The proposed Africa Trade Opportunity Act, which is currently being considered in the U.S. congress, is an example of this.⁸ Defence and aerospace industries and promotion of regional development are other areas where government support in industrial countries is well-known. The U.S. Government, for example, has been actively engaged in the rationalisation of the aerospace industry and lends all manner of support to American companies in overseas contracts. At sub-regional level, a number of states in the United States have specific programmes to attract foreign and domestic investment, providing infrastructure, credit, and subsidies of different kinds.

The industrial countries are also able to subsidise their industry and agriculture in a manner that allows them to avoid being challenged in the WTO. For example, the US Senate recently approved an emergency farm package of \$7.4 billion to deal with the last summer's drought on the East Coast, when the farmers' actual loss is estimated at no more than one billion dollars. Although the ostensible reason for such handouts (which may amount to \$24 billion, or nearly half of all farm income in 1999) is to save family farms, the real beneficiaries are widely held to be the agro-industry, dominated by two mega-corporations.⁹

The corporate influence on commercial policy is now combined with a mounting pressure from domestic constituencies—the so-called “civil society”—in such areas as labour standards, human rights, and environmental concerns. To a certain extent, such concerns are no doubt sincere, but their overall impact is likely to be protectionist and harmful for the developing countries. With the rising demands for labour market flexibility, declining trade-union membership, and pervasive “sweat shops” in many industrial countries, concerns over labour-welfare tend to have a rather hollow ring. Similarly, in view of the foot-dragging on the part of some

⁸ The implications of this law for the African countries are discussed in *Lopsided Rules of North-South Engagement: The African Growth and Opportunity Act*. 1999. The South Centre, Geneva.

⁹ The data are taken from a report in *The Guardian Weekly*, August 12-18, 1999. (p. 8) The issue is discussed in greater detail in Murphy 1999.

leading industrial countries on environmental issues, the voicing of environmental concerns in the context of trade lacks credibility.

There is in any case the danger that the linking of above concerns with trade policy and bringing them within the ambit of WTO would lead to an abuse as well as overloading of the global trade agenda. The issue basically is whether it is appropriate to make what may be legitimate social and environmental concerns subject to trade remedies, for there do exist, as in respect of intellectual property, functioning and effective international organisations to deal with these matters. This is not to deny situations where trade measures themselves may violate some existing international agreement (as, for example, trade in products of endangered species or UN- supported trade sanctions against individual countries), which obviously need to be respected by the WTO rules.

Firm Size and Globalisation

Size does not confer a cost advantage to a firm in a whole range of industries, but it does have an important strategic value, which is among the reasons why firms are driven by the goal of expanding their market share. Larger firms tend to enjoy greater power and influence in mobilising finance and political support, while being able to spread fixed costs of marketing, advertising, and R&D over a larger volume.

Competition in the world market is dominated by large firms, mostly from the industrial countries. Market concentration in world trade in such primary products as grains, bananas, tobacco, etc., has been always high, but it has increased in the case of trade in manufactures also. In addition, the increasing spread of manufacturing production across the globe is accompanied by a complex web of intra-firm trading relations. According to some estimates, as much as 30 per cent of trade in manufactures represents intra-firm trade and, if industry networks are included, the proportion could be as much as 60 per cent (Mytelka 1999). This means that a very large proportion of world trade is not conducted at arm's length, i.e., in open competitive markets. With the use of widespread use of transfer pricing by the multinationals, there is little meaning to the notion of a world price.

The already high market concentration and the recent spate of mergers among the world's largest firms raise questions concerning the nature of global competition

and the ability of developing countries to benefit from openness and closer integration into the global economy. Some of the large firms have turnovers that far exceed the national incomes of many developing countries. Mitsubishi Corporation, for example, has sales that exceed Indonesia's GNP, while Ford Corporation's sales exceed the national income of South Africa.¹⁰ Markets dominated by such large corporations are a far cry from the competitive markets of the textbooks. That developing countries approach these markets with doubt and trepidation can then hardly be irrational..

The main justification for M&As are the so-called scale economies (i.e., production costs declining with the scale of operation), yielding efficiency gains as the firm size increases. The implied scale economies, however, usually have little to do with the production process itself, but rather with the access to specialised technologies and the cost of marketing, after-sales service, advertising, and general consumer outreach world-wide. These are typically the elements of costs that rise simply as a consequence of the globalisation of production. But this creates a rather paradoxical situation. Globalisation, which is meant to increase world-wide competition, also forces firms to merge and results in increased market concentration. In such a situation, smaller firms' survival is difficult, even though they may otherwise be efficient, low-cost producers. In other words, unless they get acquired or merged with other firms, small firms have but bleak future in the globalised world. Developing country firms are generally speaking too small to be interesting for international mergers. If there is any interest on the part of foreign investors, it is for straightforward take-over, which typically results in the replacement of local management by expatriate staff.

Within the industrial countries, of course, M&As are subject to constant and close scrutiny under the prevailing anti-trust laws and regulations. There is no similar safeguard at the global level to protect smaller firms, especially those of the developing countries. Indeed, the vulnerability of the developing countries, both as producers and consumers, has risen as a result of these developments.¹¹ As sellers of

¹⁰ Reported in the *South-North Development Monitor* (SUNS), Third World Network, 5 August, 1999. No. 4492. The report was on the findings of a UN working group on the effects of transnational business activity on human rights.

¹¹ The case of the take-over of seed companies by Monsanto Corporation illustrates well the problems faced by developing countries. Monsanto spent some \$8 billion to purchase the world's leading seed

products, they often face what amount to monopsony situations and as buyers they face monopolies or oligopolies. Even in respect of manufactures, developing countries are dependent on a handful of marketing firms in the industrial countries for their exports. As importers, they often face cartel-like situations, which result in their being charged higher prices than warranted by a competitive market. Thus, for example, a World Bank study reported several instances where the African countries were charged considerably higher prices for similar products than other countries (Yates 1997) .

The rise of M&As has, in short, some important implications for trade and development prospects of the developing countries. One consequence is that developing countries' choice in industrial development has become mainly confined to activities where size is of little consequence, i.e., basically simple, small-scale manufacturing largely for domestic consumption. In situations of foreign acquisition of domestic firms, there arises the complex question of whether ownership of assets really matters. There was considerable concern and resistance in the United States as well as Europe over the Japanese take-over of their industries during the 1980s. The anxiety over ownership in developing countries can therefore be hardly surprising. In pursuit of national development, governments often have to nurture domestic industry and entrepreneurship to permit the rise of strong and large firms that can compete with foreign firms. Certainly, in Japan, there were several instances during its earlier industrial development phase when government intervened to prevent proliferation of firms in capacity creation. Chaebols in Korea played a similar role.

Mergers of business firms across the globe have a parallel in the moves to establish regional trading arrangements (such as, NAFTA or APEC), which many view as frustrating the multilateral trading system. The driving force behind these moves is also to wrest greater bargaining power on commercial, financial, or political issues. Thus, regional trading blocs are also the consequence of globalisation: the size of economies, as for firms, has come to matter as the world moves towards freer trade.

companies in order basically to control the world trade in seeds. A number of developing countries, including India, protested against this, but to no avail. However, now with the prospect of its merger with DuPont, another major chemical firm, an anti-trust suit is being brought against the firm in the United States.

Even the United States, a continental economy of immense size, has found it necessary to promote and join regional trading blocs.

M&As along with the rise of large trading blocs raise doubts on the argument for free trade. If competition in the world market is inherently unstable in the sense that it forces firms/countries to merge, then the basic premise of free trade—increased competition leading to lower production costs and other consumer benefits—becomes untenable. But free trade is also threatened because of its impact on labour. So long as labour faces barriers to movement across countries, national frontiers will continue to matter, and governments will continue to seek ways to protect national interests. In particular, there is unlikely to be a wholehearted support for imports that replace domestic production or for domestic capital moving to other countries with better profit opportunities.

In brief, for reasons of survival in the global market, firms are impelled to merge and nations seek to form large trading blocs, but this is clearly restrictive of competition. The fact is that a situation where a large multitude of small firms compete is fundamentally unstable since they have every incentive to merge with each other in order to take advantage of the market. There can be little enthusiasm for globalisation in countries whose industries and firms face the prospect of disappearance.

To conclude, free trade is a moving target. Even if all trade barriers were removed, it would still leave open the question of the rules that should govern competition in the world market, whether it concerns products or factors of production. Indeed, as tariff barriers come down, the rules governing world competition assume greater importance, especially as far as the developing countries are concerned. There is no assurance that the world's leading corporations would help to promote national development of individual economies. This is so both because national and firm-level interests may not coalesce and because an environment of liberalised trade and free capital mobility has tended to make investors short-sighted. This suggests the need for a global competition policy to govern the conduct of multinational firms as well as protect consumer interests in the developing countries.

3. Preparing for World Competition

An economy is said to be internationally competitive if it is able to produce goods and services that meet the test of the world market, but it does so while the real incomes of its citizens are rising (Tyson 1993). Thus, according to this definition, the economy which can compete in the world market only by pushing down its general standard of living (as, for example, through devaluation) would not be considered internationally competitive. The productivity of labour plays a centrally important role in international competitiveness, for it is not only a key factor in determining production costs, it is also an indicator of an economy's productive potential.

There are basically two channels through which the overall productivity of labour can rise: through technological improvements in existing productive activities or through the rise of activities with higher value-added per worker, e.g., industry compared to agriculture. Competitive pressures and market signals do make producers look for ways to raise productive efficiency and move production towards higher value-added activities, but they alone are not sufficient, even in mature industrialised economies. For one thing, producers are concerned primarily with the share of labour cost in the total rather than with productivity as such. If wages can somehow be kept low, producers have little incentive to invest in productivity enhancing measures, for example, investing in new machinery and worker skills. Market prices are also not reliable or adequate as signals for guiding investment for long term growth and development of an economy. Industrial country governments have often had to guide investments into what are deemed to be strategic industries. In developing countries, of course, the physical and institutional constraints as well as market imperfections that prevent long-term industrialisation are much more serious.

A common criticism of public policy aimed at economic transformation is that governments are incapable of "picking winners", for they are driven by diverse objectives and are not competent or knowledgeable enough to take sound economic decisions. This view is buttressed by a large body of evidence on failed industrialisation in developing countries. Nevertheless, there is hardly a case of economic development where government did not play an active role; the experience of the East Asian economies is particularly apposite.

The question, however, is really not one of choosing winners but one of creating them. Countries fail to industrialise not so much because of wrong choices with regard to specific industries as for neglecting to provide the conditions and environment where enterprise could thrive. The choice of a path to industrial transformation can be likened to the selection of a profession by a high-school graduate. Inherited abilities (factor endowments) and personal preferences (national aspirations) are obviously crucial to the decision, and ignoring the state of the job market (world market conditions) could be perilous. However, a niche can be created in virtually any specialisation through investment, inventiveness, and perseverance, though luck also tends to intervene in surprising ways.

Where a country might develop its competitive advantage may, therefore, not be evident from its factor endowments or existing market conditions¹², and strategic choice about development of economic activities may be necessary. In discussing what countries can do for themselves, the role of trade policy is discussed first for it raises issues that have international dimensions. This is followed by a discussion of other support measures that may permit countries to take advantage of openness and the global economy.

The Role of Trade Policy

Mainstream economists tend to dislike trade policy because it runs against the established notions about the functioning of markets and virtues of free trade. Quantitative import restrictions (such as, import licenses and quotas) and high and variable rates of import duty are particularly disfavoured, for they make market signals more seriously distorted. Trade liberalisation is recommended in order to reduce these distortions and minimise the effect of government interventions on producer and consumer choices. An important goal is to make countries “outward oriented” by reducing the bias against exports that protection creates.

¹² Holland’s flower growing and exports is a well-known example of created competitive advantage, for the country’s factor endowments or world market conditions were hardly favourable to this industry.

Trade policy serves basically two purposes: the management of the balance of payments and the protection of nascent domestic industry.¹³ With respect to the balance of payments, the exchange rate is regarded as the preferred policy tool for bringing about the needed adjustment, though in practice it poses certain problems. Trade balances, even in the industrialised countries, show little systematic or predictable response to currency values. The reason is that the impact of the exchange rate (a nominal measure) on the trade deficit (a real variable) is transmitted through its effect on the prices of non-tradables relative to the tradables (often referred to as the “real exchange rate”). There is no guarantee that an exchange rate adjustment will have the desired change in the real rate, or that the change in the real rate on its own will bring about the needed adjustment in the trade balance.¹⁴ Thus, direct import restrictions and foreign exchange controls often become necessary in the management of the balance of payments. It is in recognition of this that the WTO and IMF rules provide for temporary, albeit last resort, use of such means.

The “infant-industry argument”, i.e., the use of trade policy to protect domestic industry, has a long history, dating back to the industrial development of Germany and the United States. The basic argument is simple and persuasive: in the earlier phases of industrial development, countries face handicaps that put their industries at a disadvantage with respect to the more advanced countries. Protection is needed to allow industry to take root in the late-comers to industrialisation. Although there are some advantages in starting late—for example, learning from others’ experience and borrowing technology—there are also some distinct disadvantages, notably, the difficulty in penetrating established markets and accessing already appropriated technology. There are also the problems of poor infrastructure, deficient and underdeveloped capital markets, and poor management skills as well as weak institutions.

A major criticism of protectionist policies is that, apart from distorting incentives, they foster corruption and “unproductive rent-seeking activities” that are costly in terms of using up resources. This certainly has some validity, but there are two points to consider. One, a policy need not be rejected just because it has some undesirable side-effects. Thus, for example, it is well-known that all taxes are

¹³ The literature also notes its use to influence the terms of trade, but it is of little practical value.

distortionary and enormous resources go into finding ways to evade their payment, but few suggest that tax policy should be abandoned altogether. More importantly, there is no evidence that increased reliance on the market through trade liberalisation, deregulation, and privatisation has brought down corruption and unproductive rent-seeking. If anything, the evidence from developing countries and transition economies points in the other direction.

Mainstream economists also note that such disadvantages as industry in developing countries faces have their source in the domestic economy, not international trade, and therefore do not justify trade policy interventions. Market failures need to be addressed at their source, through government subsidies for example. However, the real value of trade policy is its being practical. Raising revenue is never easy, but taxes on trade are easier to collect, and developing countries have long experience in this regard. Subsidies, on the other hand, are difficult to administer and few developing countries succeed in properly financing them through increased revenue.

The important point, however, is that developing countries require protection from *foreign* suppliers, for it is they who enjoy all the advantages of early start and established presence in the market. It is not just with respect to production costs that new firms are at a disadvantage, but also, and more importantly, with respect to what are called “intangible assets”, i.e., brand recognition, marketing networks, and accumulated knowledge and experience. To this must be added the fact that given their weak economic and political base, developing countries often have little power or influence over the activities of foreign suppliers. Thus, while regulations against predatory pricing are rigorous in the industrialised countries, they are rare in the developing countries, and if they exist, they are hardly ever enforced. In the matter of anti-dumping duties also industrial countries seem to use them to greater effect.

To put it differently, since industrial development entails domestic production replacing imports. it is from imports that newly industrialising countries need to be sheltered. Import-substitution is not inconsistent with the traditional model, which holds that a country’s comparative advantage would shift towards the importable products following capital accumulation, building up of human capital, and

¹⁴ This point is discussed more fully in Haque 1999.

development of capabilities to manage and generate technical change. However, for reasons already discussed, a country cannot be expected to become immediately internationally competitive in new productive activities.

The literature on the failure of the import-substitution strategy in developing countries was in the nature of a growth industry during the 1970s and 1980s, and played a crucial role in the rise of market fundamentalism.¹⁵ However, the critique of the import-substitution strategy itself went through an evolution, mainly as a result of the accumulating evidence and the changing interpretation of the experience of the East Asian economies, whose evidently successful “strategies” held important lessons for other. The initial view that these were less protected economies than the Latin American countries could not be sustained by the actual evidence. It was then argued that while protection in East Asia was high, government policies had ensured that export activities were not discriminated against. In other words, the incentives system was neutral between export and import-substituting activities, a hypothesis that has been difficult to prove.¹⁶ Subsequently, their success came to be attributed to the aggressive promotion of exports through all manner of policies and incentives (most notably, in World Bank 1993).

The enthusiasm for trade liberalisation and export-led growth has now begun to yield to more sober reflection and assessment of the evidence. Several earlier studies had cast doubt on the exaggerated claims made for the benefits of trade liberalisation (see, for example, Havrylyshyn 1990 and Dornbusch 1992). The efficiency gains from improved resource allocation were never believed to be very large (often referred to as “Harberler triangles”), but recent studies also report that there is no significant impact on economic growth (See, e.g., Ocampo and Taylor 1998 and Rodrik 1999). Rodriguez and Rodrik (1999) show not only that trade restrictions and economic growth have little relationship, but the methodologies used to prove a positive relationship were also questionable. They note: “...we are skeptical that there is a strong negative relationship in the data between trade barriers

¹⁵ Jagdish Bhagwati, Anne Krueger, and Bela Balassa were among the most ardent critics of protectionism and import-substitution strategy. The World Bank’s *World Development Report 1987* offers one of the most strident (though not entirely objective) critiques of the import-substitution strategy.

¹⁶ Pritchett (1996), for example, shows that there is no satisfactory way of measuring outward orientation.

and economic growth, at least for levels of trade restrictions observed in practice. We view the search for such a relationship as futile.” (pp. 38-39)

Questions are also being raised on the benefits that ensue from outward-orientation and aggressive export promotion, also referred to as “export fetishism” (Rodrik 1994). It is shown that a dollar worth of investment in exports does not necessarily have a higher pay-off than in other activities. The promised spill-over effects for technology development are no stronger in export activities than import substitution. Exporting by itself, just as import-substitution, is not sufficient to create the basis for strong indigenous learning and knowledge-accumulation process (Bruton 1998). There has recently been a resurgence of export-pessimism, as developing countries face constrained export markets in the face of slow growth and continuing high unemployment in a number of industrialised countries, with the consequent rise in protectionism (see, for example, UNCTAD 1999). Thus, attempts at expanding exports have resulted only in excess capacity in developing countries and falling prices in the world market.

In short, a more nuanced view seems now to be gaining ground, which holds that the choice for developing countries is not between import-substitution and export-promotion—for both are needed—but rather one of establishing internationally competitive industry. Just as there are easy stages of import-substitution, there are also easy stages of export-promotion, when the results in terms of economic expansion can be quite dramatic (Bruton 1998). Once this stage is passed, decisions on the direction of investment and economic growth become more difficult. As wages rise with economic advance, the traditional advantage in labour-intensive industry must give way to more advanced sectors, and this is a continuing process. But this transition cannot always be left to the dictates of the market. As Korea and other industrially more advanced developing countries have discovered that the transition from simple labour-intensive industry to technologically sophisticated industries is not easy or straightforward.

Before concluding the discussion on trade policy, it is necessary to address a question that is frequently raised, that is, whether protection in one country would not upset the “level playing-field” and induce retaliation on the part of countries affected. The fact is that retaliatory action is possible against all measures that affect foreign

trade, not just trade barriers. Thus, for example, the competitive devaluations and deflationary policies of the 1930s were major factors to deepen the Great Depression. The context in which trade policy interventions take place also matters. If trade policy enables an economy to grow more rapidly, it is unlikely that this would harm other countries. In fact, higher growth in one economy tends to stimulate growth of other economies through a rise in the demand for imports. Thus, despite their protectionist policies, the rapid growth of the East Asian economies, with a rapid expansion of their own markets, served only to stimulate economic growth in other economies. They continued to run large trade deficits, with imports continuing to run ahead of the phenomenal growth of their exports. In fact, the size of the markets of the newly industrialising economies is a major attraction for exporters and investors in the industrial countries. Whether policies hurt other countries, therefore, depends basically on their design and goals. Policies that are aimed at expanding markets and promoting economic growth can hardly be bad for the world. On the other hand, contractionary macroeconomic policies that depress demand, output, and employment can be seriously damaging for the world trading environment even though they do not directly restrict imports.

“Making Openness Work”

Adherents of protection and advocates of trade liberalisation both share a common belief in the potency of trade policy, although obviously from diametrically opposed positions. The first group views trade policy to be a powerful tool that can be used to lay the foundations for industrialisation, while the other regards trade policy as a source of much that is wrong in developing countries. However, experience has shown that neither protection nor trade liberalisation by themselves provide the basis for internationally competitive industrial growth. Protection has been used to good effect in a number of cases, and there is support for temporary measures even among many mainstream economists. On the other hand, trade liberalisation can also be beneficial where economies are excessively protected, denying access to needed imports, or when trade policy is poorly managed, with redundant import restrictions and cumbersome procedures for import permits. The reality is that countries have rely on trade policy for all sorts of purposes, but some do it more effectively than others. The question turns basically on arriving at the

“optimum degree of openness” which depends on a host of factors, notably, a country’s size, natural resource base, stage of development, etc. (Singh 1991)

A body of opinion has emerged that, while recognising the need for openness and integration into the global economy, holds that it is ultimately capital formation and technological or knowledge accumulation that are fundamental to economic growth. (See, in particular, Rodrik 1999, which is subtitled “Making Openness Work”, and Bruton 1998). The latter in turn are held to depend on a host of socio-economic, political, and institutional factors, that fall broadly under the heading of “governance”. The discussion here is limited to technology policy and domestic competitive environment as they have a direct bearing on openness and a country’s ability to take advantage of the global economy.

Technology Policy. There are certain features of knowledge generation and use that make government involvement essential. The market in technology (i.e., the ability to buy a bit of information for a given price) either does not exist or, if it exists, it is highly imperfect. This is mainly because knowledge is a so-called “non-rival” good, i.e., one that does not diminish with use and because there is little or no cost involved in sharing it with others. However, if knowledge is made readily and freely available, private firms, whose principal aim is to make profits, will have little incentive to invest in research and development (R&D). On the other hand, if knowledge could be fully appropriated—for example, by rigorously enforcing intellectual property rights—there may be considerable duplication of effort as firms compete with each other to capture the “first-mover” advantages.¹⁷ Thus, the market is liable to cause either too much or too little investment in knowledge generation.

Another complication is that knowledge is cumulative, which means that the absorption and use of new information depends very much on prior knowledge base. Thus, a cooking recipe followed by a master chef yields a totally different result from one that comes from a novice. This is of particular significance to the developing countries, whose initial technological base is quite limited. Thus, becoming competitive in a particular line of productive activity does not only involve *transfer* of

¹⁷ The duplication of research effort, however, is not necessarily wasteful of resources. Solution to an intractable problem is often found when separated researchers approach it from different angles.

technology, but also building up local expertise and technological capability over time. This has costs that private firms may not be too eager to incur.

Governments can influence learning and accumulation of knowledge through basically three channels: general education, worker training to upgrade skills, and building up the nation's technological capabilities. The first two have of late received considerable attention both at international level (e.g., the World Bank, ILO, and bilateral donors) and at country level. Government's role in promoting education, being in the nature of a public good, is universally recognised, though it remains a neglected and problem sector in a large number of developing countries and even some industrialised countries. Governments can also do a great deal to promote skill-training, for private firms, for fear of losing trained workers, tend to under-invest in this area.

While education and training are certainly critical in developing a country's resource base, they are by themselves not sufficient in creating an environment conducive to technological growth, which is what is required in order to survive and thrive in a changeable, competitive world. The capabilities to generate and manage of technical change do not just lay the basis for innovation, but are also needed to take advantage of knowledge diffusion. There is considerable inventiveness required in adapting technologies to local situations and improving them over time (Bell and Pavitt 1995). An open economy, of course, can benefit both from the channels of diffusion that foreign trade provides and from the outside competitive pressures, but it is evident that in order to take advantage of these possibilities, countries need to have appropriate domestic conditions. Here governments again have an important role. Defining a course of industrial development has played a crucial role in the development of technologies in industrial as well as developing countries. A notable example was the launching of the U.S. space programme that spawned a host of commercial innovations. Ultimately, it is governments' task to define and develop a "national system of innovation", i.e., the institutional arrangements governing the conduct and sharing of innovative activity.

Domestic competitive environment. Domestic competitive environment refers to the conditions that allow firms to grow and compete, in particular, government policies and institutions that promote firm-level behaviour that is supportive of national

development. The concern here is, therefore, rather broader than the issue of national competition policy, which is basically aimed at defining the rules for domestic competition, specifically with respect to the emergence and functioning of monopolies.

In the early phase of market fundamentalism, it was commonly believed that once governments deregulate and liberalise trade, and generally “get off the people’s backs”, private enterprise could be relied upon to do all that was needed for national development. There is, however, little evidence that suggests that private enterprise performs best in a laissez-faire setting or that its singular drive for profit is always consistent with the goal of furthering national development. Many of the government’s policies and regulations, even in industrial countries, are aimed at helping individual firms to grow and flourish and at ensuring that the search for private profit does not compromise social goals.

As noted earlier, some types of competition, far from stimulating enterprise, can be destructive and there are situations where collaboration and cooperation among firms can be helpful in achieving national objectives. Thus, for example, trade liberalisation in many developing countries proved to be destructive because domestic firms were just not prepared in advance to cope with the sudden increase in foreign competition. Cheaper imports can certainly help to reduce monopoly profits that firms enjoy under protection or force them to look for means to reduce domestic costs. But trade liberalisation is hardly the answer if monopoly profits are simply due to domestic barriers to entry of new firms or if there are some structural reasons for production costs to be high.

Governments obviously need to ensure that domestic producers face a level playing with respect to production conditions, i.e., the availability of physical infrastructure, raw materials, etc. But the size of the domestic market may not permit a large number of producers to compete and survive in developing countries. Governments in East Asia, in their early phases of industrialisation, were particularly careful in regulating the degree of competition in different activities, depending on domestic market conditions. They encouraged mergers and cooperation among firms and often denied permission to expand capacity by new entrants. They also used a system of incentives and penalties to guide private investments into lines of activities

deemed to be important for the long-term growth and development of their economies.

For government to be able to play its proper role in the direction of the economy, there must first exist a broad consensus (democratically arrived or imposed by the ruling party) within a country as to its appropriate role; it seems to matter rather less as to what that role actually is. Policy to redirect economic growth can hardly succeed in countries where the government's role in devising economic rules, redistributing national wealth, or investing in productive assets remains contested. This can be most clearly seen in the context of the transition economies. Where a measure of consensus has emerged (as, e.g., in China and a few Eastern European countries), countries have been embarked on the path of economic growth, but economic instability persists in countries where there is still considerable uncertainty as to the appropriate role for the government (as, for example, in Russia).

The important point, however, is that there is no unique model of capitalism that developing countries may emulate. As Rodrik (1999) notes: "It is not realistic to expect that national development efforts will converge to a single model of 'good economic behavior'; nor is it desirable that they do so. The lesson of history is that ultimately all successful countries develop their own brands of national capitalism. The economies that have done well in the postwar period have all succeeded via their own particular brand of heterodox policies." (p. 3)

Towards Levelling the Playing-field

The playing-field of world commerce is tilted against the developing countries, and steps are needed to make the rules and general environment of world competition more even-handed and neutral. However, that will not be enough. Even after the playing-field has been levelled, there will continue to be a need for differentiating between player strengths. Just as in some sport events, handicaps are allowed to make the contest more meaningful, the world community is likely to benefit from a world trading environment where the economically weak and handicapped have a chance to thrive, rather than get eliminated by the economically strong. There can be little doubt that growth of developing countries not only

provides expanding markets for the industrial countries, but also enhance the prospects of world peace and security.

Enlarging Policy Space

One of the ironies of globalisation is that it has constrained national economic policy-making while making it more critical for sustaining economic stability and growth. What countries can do at national level is now severely constrained by the relatively free movement of capital and obligations to international organisations, notably, the triumvirate of IMF, the World Bank, and WTO. Slight deviation of the economy from what asset-holders perceive to be the correct course can quickly be punished by capital outflows that cause financial instability. Thus, policies must not only be sound from the perspective of the country concerned, but also seen to be so by asset-holders, with their own notions and expectations. At the same time, the conditionalities imposed by the international financial institutions and obligations under the WTO treaty have considerably circumscribed the national policy space for the developing countries.

Globalisation has not eliminated the nation state and national boundaries. The fact that asset-holders can move their capital across countries with relative ease has only helped to raise the concern with the welfare of ordinary citizens who cannot move or do not wish to abandon their native environment. Restrictions on the movement of labour internationally, certainly as far as developing countries are concerned, seem to have increased over time. Thus there is ground for concern if governments have to give up policies that are aimed at protecting national interest in the face of outside pressures.

The external constraints on policy-making may have a useful role as a disciplining device. With greater global integration of economies, there is, for example, less likelihood of reckless fiscal or monetary policies, indefinite neglect of the exchange rate, or extreme forms of protectionism. Governments may also occasionally find the dictates of international organisations politically convenient, for they can “sell” difficult policies domestically by blaming the outsiders. But the problem with the outside “policy advice” has been that it has been too insistent and

wide-ranging, largely ideologically motivated, and experimental in nature.¹⁸ Typically, those proffering advice have little or no experience at national policy-making level and limited knowledge of local political and institutional limitations.

The external pressure for economic and political reform has tended to be directly proportional to the seriousness of economic distress that a country finds itself in. The example of African countries being forced to undertake reforms without regard to local conditions is well-known, but even the East Asian economies were not spared when they were made to embark on reforms that went well beyond what was needed to deal with the immediate problem of the financial crisis (Feldstein 1998). Yet, there is evidence, gathered by the international financial institutions themselves, that externally dictated reforms seldom, if ever, take root in countries concerned and that the success of reforms is contingent on domestic ownership.

But the developing countries need greater policy autonomy for another reason: they must be allowed to make their own mistakes and learn from them. This may not always work and will certainly involve long learning period. In any case, as noted earlier, there is not just one model of successful capitalism. Certainly, countries can and do learn from others' experience, but policies are defined by their context, which varies over time and across countries.

In order to expand the policy space for developing countries, there are basically three sets of measures to consider. First, some of the externally imposed constraints on policies (such as, on trade policy under the WTO) need to be relaxed for the developing countries. This point is further discussed below under special and differential treatment. Secondly, developing countries must have greater involvement in the definition of conditionality associated with the lending by the international financial institutions. Countries are meant to define their own policies at least notionally, but in reality the pattern has been one of making countries conform to what came to be called Washington Consensus, consisting basically of restrictive fiscal and monetary policies combined with market liberalising measures. And,

¹⁸ The experimental nature of the advice was captured well, though rather cynically, by a story narrated by a retiring Senior Vice-President of the World Bank. He talked of a farmer who started losing his chickens due to some disease. Every time he visited the local doctor, he was prescribed a different medicine for the chickens. However, nothing worked, and all the chickens eventually died. The doctor's response on learning about the tragedy was simply: "Pity, I had still some remedies left to try."

finally, developing countries need to have much greater voice in the management and running of the international financial institutions and the WTO. The issue of global governance has received considerable attention recently, but so far too little avail. Within the context of the WTO, a major issue also has been expanding the developing country capacity to participate and negotiate on traditional as well as emerging new issues.

Special and Differential Treatment

In arguing for special and differential (S&D) treatment for developing countries, the purpose cannot be to set aside an individual country's responsibility in creating conditions where robust industry can take root, but rather to underscore that the openness to world markets, in the absence of adequate safeguards, can undermine such efforts. Thus, in addition to levelling the playing-field of world commerce, it is deemed necessary that world trading rules make allowances for countries' different stages of development and abilities to compete in the world market.

S&D treatment was part of GATT articles and is recognised in the WTO, even though questions continue to be raised as to its value.¹⁹ A significant change, however, occurred during the Uruguay Round, which effectively reformulated the issue of S&D from one of being concerned with the special rights and provisions that developing countries needed in trading rules to support their development efforts to one of being concerned primarily with arrangements that facilitate developing countries' integration into the global economy (Whalley 1999). In other words, the concern is not with allowing *departures* from existing rules to permit greater flexibility to developing countries to pursue their development objectives but rather with ensuring that they get integrated into the global trading system in the shortest time period possible. What the Uruguay Round provides is basically longer time periods to developing countries for implementing the key agreements resulting from the round, notably in the new areas of intellectual property rights and investment measures.

¹⁹ For a fuller discussion of S&D treatment, see "Special and Differential Treatment to Developing Countries in the Multilateral Trading System: The Road Ahead". South Centre. TRADE Working Papers No. 2. South Centre. Geneva. 1999.

This shift was very much in tune with the rise of market fundamentalism, which holds openness and integration of the developing countries to be a desirable goal by itself. The World Bank in particular propagated the notion—largely unsubstantiated by facts—that unilateral trade liberalisation on the part of developing countries was of direct benefit to them. In other words, developing countries were enjoined to proceed with trade liberalisation without regard to the offers of other countries or waiting for the outcome of the Uruguay Round. It is now generally recognised that developing countries gave too much and gained too little in the Uruguay Round.

In restating the case for S&D treatment, the issues of non-reciprocity and national treatment are of central importance. This paper has underscored basically three sources of weakness that call for greater prudence on the part of developing countries in opening up their economies and integrating with the global economy, i.e., vulnerability due to infant industry, relatively small size of firms, and inadequacy of administrative and financial resources to defend their national interest in WTO and other international negotiating bodies. Protection of nascent industry from foreign competition is a well-trodden argument and need not be repeated here. The second source of the developing country vulnerability is the process of globalisation that has tended to put a premium on the size of firms in a wide variety of industries and agribusiness. The issue of protecting domestic firms from foreign take-overs turns essentially on the importance of ownership in building up national capacities for development and growth. Although hard data on the significance of ownership for national development are lacking, it is clear that multinationals, despite their extensive international reach, remain conspicuous for their *national* origins. Their enormous financial might is often combined with the political backing of their governments in their dealings with the developing countries. The only tool developing countries have at their disposal to “tame” the multinationals is “performance requirements”, which too is under attack within WTO as being inconsistent with “national treatment”.

The issue of performance, however, is closely linked with preferential treatment of domestic producers. In defining a system of incentives and penalties, governments require commitment from businesses to meet certain specified goals and

meet certain performance criteria. This was an important feature of the industrial policy in the rapidly growing East Asian economies: the incentives were balanced by penalties. Thus, despite the TRIMs (trade related investment measures) agreed, the issue of performance requirement cannot be deemed to be settled.

There is also increased appreciation of the third factor: developing countries' capacity to cope with the legal overload of trade issues. The industrial countries first introduce new issues for negotiation, then use WTO mechanisms to enforce them. The developing countries, on the other hand, lack the expertise and staff to study these issues, even less so negotiate and put up legal defence to protect their interests. Technical assistance to cope with this problem was provided at the time WTO was established, but it has not been particularly effective in overcoming the core problem.

“National treatment” has been one of the most valued guiding principles of the current framework regulating world trade, both in the GATT and WTO. The principle is that no policies must be adopted that discriminate between foreign and domestic suppliers. It parallels, in a sense, the most-favoured-nation (MFN) rule that operates at the international level, i.e., a country must not discriminate among foreign suppliers (though it concerns only those countries who are members of WTO). The issue of national treatment has particular significance for the developing countries because of their early stage of economic development. In order to foster national development, they will continue to need to accord preferential treatment to domestic producers. Some discrimination in favour of domestic producers at early stage of industrialisation is at the heart of industrial policy.

Treatment of IPRs

Technological progress, which is the key to the rise in living standards and international competitiveness, comes about either through innovation (i.e., the development and application of new ideas) or through the diffusion of already existing ideas to new users. The distinction between innovation and diffusion in practice is not sharp, for borrowed ideas or techniques need considerable modification and adaptation to suit specific situations. Nevertheless, it is a fair characterisation that industrial economies are the principal source of innovation and the developing world to a large extent relies on the diffusion and transfer of technology for building up its

productive base. Thus, access to existing technologies and ideas and means to help them building up their own capacities to innovate are matters of deepest concern to the countries of the South.

There has always been a certain tension between the proprietary nature of knowledge and the social need for spreading it widely. The private individual expects and seeks to be rewarded for investing in the development of knowledge or through means that restrict others' access to that knowledge. But this has certain social costs. The diffusion of knowledge not only increases the number of beneficiaries, but it also, through an interchange of ideas, helps knowledge to grow. Thus, public policy on intellectual property rights (IPRs) has had to reconcile two conflicting goals: the need for the owner of knowledge to earn a reward (which need not always be pecuniary) and society to get access to it. Patents, copy rights, trade secrets, etc. have been all used to serve the dual purpose of allowing monopoly rents (for a specified period of time) or other non-pecuniary privileges to the owner of knowledge, while making it possible for others to have access to it for a price.

The reconciliation of the two goals, however, has never been completely satisfactory, and the established legal barriers to protect IPRs, especially across countries, have tended to be porous. The extension of the multilateral trade negotiations under the Uruguay Round to include IPRs was driven by a desire on the part of industrial countries to "tighten up" the application of the existing laws, with clear penalties for non-compliance. The Agreement on Trade-Related Intellectual Property Rights (TRIPs) was a major outcome of the Uruguay Round. That this agreement has the potential of having negative impact on the industrial and agricultural development in the South is a serious matter for all developing countries.

The TRIPs agreement raises some profound questions concerning the level of the playing-field and its consequences for the developing countries. For one thing, the negotiations leading to the TRIPs agreement were asymmetric in that while there was little "give and take" on the issue of IPRs (unlike negotiation of other trade matters within the established multilateral framework), recourse to cross-retaliation for non-fulfilment of specific obligations is provided. It is also clear that the agreement is biased in favour of innovator rather than the user of knowledge. It makes little provision for technology transfer and, more generally, for fostering

economic development of the South. Indeed, the industrial countries are now under no obligation to exploit patents locally, but are encouraged to substitute export of products for the transfer of technology. A direct consequence, which is now widely recognised, is the increased monopoly power of drugs and pharmaceutical producers and the likelihood of rising prices for the developing countries (Duran and Michalopoulos 1999).

By bringing the matter of IPRs within the ambit of WTO, industrial countries have been able to broaden the scope of covered areas. Thus, for example, software producers in the United States have been able to bring computer programming under the copyright law, despite the difficulties of applying it to functional works. Similarly, in the field of biotechnology, there is a wave of claims to patent living forms of all kinds, though the TRIPs agreement itself provides for some transitional solutions which will be reviewed by the year 2000. But here, as in other respects, there is a glaring asymmetry as far as the developing countries are concerned. While patents, trade marks, copy rights, industrial designs provide protection to producers in the industrial countries, the developing countries face a situation where their local folk tradition in music, art, and design could be appropriated by the North with no or little recompense to actual producers in the South.

The rise in claims for patents for some agricultural products (e.g., basmati rice, neem, haldi, and karela) that have been produced in developing countries from times immemorial is disturbing both for the evident abuse of IPRs and for the cost developing countries must incur to fight them in industrial country courts. These claims may be frivolous, but they have set a dangerous precedent for those in the industrial countries that regard nothing as out-of-bounds as far as patents are concerned.

For all these reasons, there is clearly a need to reopen the discussion on the IPRs, whether it takes place in the context of the periodic reviews foreseen in the TRIPs agreement itself or at the next round of multilateral trade negotiations if it gets launched at the WTO ministerial meeting in Seattle. The industrial countries can be expected to seek further strengthening of IPR regimes and raising the standards of protection, but these occasions provide the only opportunity for developing countries to introduce changes that give greater weight to the developmental aspect of IPRs and

more generally are supportive of developing country interests. This requires, in the first place, that the developing countries formulate a coherent position on how one of the agreement's key elements is to be implemented, i.e., "the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations."

Secondly, the developing countries should seek broadening the TRIPs negotiations to cover property rights in areas of particular interest to them, viz., the use of traditional practices and remedies as well as with respect to biotechnology and the environment. (This suggestion is discussed in Whalley 1999).

Industrial Country Macro Policies

The world-trading environment is defined basically by the policies of the industrial countries. Access of to their markets is a key determinant of developing countries' ability to grow and develop. Protection of agriculture and textiles as well as the problem of tariff peaks are widely recognised, though progress remains elusive. UNCTAD (1999) has estimated that lowering of industrial-country protection in a few light manufactures of interest to developing countries (such as, footwear, textiles, rubber products, etc.) could result in an increase of developing country exports of something of the order of \$100 to \$500 billion, depending on the assumptions concerning the growth of the markets.

There can, therefore, be little doubt as to the importance of efforts to bring down protectionist barriers in the industrial countries. However, no less important for market access are the industrial country macroeconomic policies that determine the growth of output and employment. There are three reasons for this. One is simply the size of the market: economic expansion implies growing markets. However, a more important reason is that protectionist pressures are directly related to the state of the labour market. When unemployment is high, imports tend to be the first target of national anger. A related consideration is that if imports from developing countries actually lead to reduced production in certain sectors, those who are thus made unemployed are more likely to find alternative employment in an expanding economy. In other words, structural adjustment, which is needed in industrial

countries in response to the emerging division of labour, is less likely to be resisted within a general climate of economic growth and prosperity.

It is for all these reasons the current preoccupation in industrial countries with fighting non-existent inflation is deeply worrying for the developing countries. There are routine reminders at the meetings of the IMF and the World Bank to some industrial countries to institute more liberal fiscal and monetary policies, but the general environment remains one of fighting inflation. The question of how policies of the industrial countries be influenced is key to the issue of global governance. This requires developing countries assuming an active role in the surveillance of industrial-country policies, which may necessitate forming their own grouping parallel to the Group of 7.

Global Competition Policy

The issue of national competition policy has become prominent within the WTO agenda. The rationale is that trade liberalisation measures could be nullified by a domestic competition environment which continues to be discriminatory against imports. Local monopolies may offset reduced tariffs through their pricing practices and purchase arrangements. However, there is also a need for some rules to govern the competition in the global market. In some sectors—e.g., food grains and even garments—there are a few large multinationals that dominate the purchase and distribution channels. They act as monopsonists when it involves purchases from producers in developing countries and as monopolists when selling. This is clearly a serious market imperfection which works generally against the developing countries, mainly because of their small size. Just like monitoring of the macroeconomic policy discussed above, here too there is a need for some supra-national body that can ensure that competition in the world market also remains fair and equitable.

5. Conclusions

The discussion of trade and development issues of late has been narrow and largely legalistic, preoccupied as it has been with the rules governing the conduct of world commerce. The concern with the broader objectives of economic development, growth, and employment has been at best incidental. This has occurred as the locus of discussion on trade and development shifted from the collectivity of UNCTAD,

GATT, and other UN organs to exclusively GATT, now WTO. However, recently, a body of opinion has emerged that would like to see “development dimension” brought back into the discussion of trade issue. The U.K. Minister of International Development, Mrs. Claire Short, has called the proposed round of multilateral trade negotiations, which may be launched at the Seattle ministerial meeting, as the “Development Round”. The new Director General of WTO, Mr. Michael Moore, has also voiced a similar view.

This paper has attempted to outline the issues that need to be addressed if indeed the next trade round would make the developing-country interests its primary concern. But the paper goes beyond that. It tries to show that many of the South’s concerns with trade and development are not covered by the WTO’s mandate or current trade agenda. However, this does not lend itself to the conclusion that these other issues ought to be brought within the ambit of the WTO and made part of trade negotiations. It would be preferable that they be taken up in other international fora. This position, therefore, is a departure from the industrial countries’ approach of bringing under the umbrella of the multilateral trading system an increasing range of issues, however tangential or tenuous their link to world trade. The result has been that it has seriously strained the negotiating agenda while stretching to the outer limits developing country capacities to grasp, analyse, and negotiate on these issues. There is now the need to delimit the WTO’s mandate and to define and agree upon the domain to which multilateral trade disciplines should apply. Just the fact that an issue has a bearing on international trade cannot be a sufficient ground for its inclusion as an item for negotiation under WTO. A number of mainstream economists have also voiced concern over the undue expansion of the trade agenda.

There is no question that multilateral trading system has been by and large successful in its principal area of concern, i.e., bringing down barriers to trade. But the market access problems of the developing countries remain serious not only in agriculture and textiles—the egregious cases of protection in the industrial countries—but in a wide range of other products as well where developing countries have a competitive advantage. These areas obviously should also be the target of the next round.

However, from the perspective of the developing countries that just will not be enough. Free trade is a moving target. Even if somehow all barriers to trade could be removed, the world would still not approximate the ideal of free trade. The so-called “merger-mania” that we have witnessed over the past few years gives an indication of how the goal of competitive markets would be compromised as globalisation proceeds. Monopolistic or oligopolistic practices of the large corporations are likely simply to replace government-imposed trade barriers in keeping the playing-field tilted in their favour. Past record does not suggest any basis for expecting the world’s largest corporations to turn altruistic and committed to ameliorating the developing country conditions.

Here, as in other respects, it is the developing countries that face the real threat: gains and losses among the industrial countries from globalisation and market liberalisation are likely to balance out. The bargaining position of the developing countries is weak for reasons of their being poor and divided, but they also lack the defences that exist in the industrial countries, such as anti-trust and consumer protection regulations. The danger indeed is that their vulnerability to outside events and pressures will worsen with the dismantling of their trade barriers and other regulations governing trade and conduct of foreign corporations. There is indeed a case for an agreement on a global competition policy that governs the behaviour of corporations with respect to world trade and foreign investment.

The absence of “development dimension” is nowhere as significant or conspicuous as in respect of the TRIPs agreement. There was, in the first place, little justification for bringing the IPRs within the multilateral trading discipline, a point that has been made by several leading economists who otherwise subscribe to the principle of free trade. It was basically at the insistence of certain industrial countries that the issue came up for negotiation, which perhaps explains the agreement’s bias. There is virtually complete neglect of the interests of developing countries, as the agreement makes little provision for technology transfer or protection of consumers against undue price increases for essential drugs and pharmaceuticals that would follow from the enforcement of IPRs. In fact, since the TRIPS agreement, the situation from the perspective of developing countries has only worsened with the rise of basically frivolous patent claims in industrial countries against agricultural

products that have been produced since the dawn of civilisation. Fighting these claims is extraordinarily expensive for developing countries. Clearly, there is a pressing need for reopening the question of the proper domain for the exercise of IPRs and the way they are to be enforced. This could be done either at the foreseen reviews of the TRIPs agreement or at the next round itself.

Nevertheless, the rigorous enforcement of IPRs has one incidental benefit that cannot be ignored. It has underscored to the developing countries the value of investing in innovation and knowledge creation. Capabilities to generate and manage technological change have become as relevant in traditional (agriculture, simple manufactures) as in new high-technology sectors. Indeed, economic transformation and technological change can be seen as handmaidens, where they support each other in a virtuous circle of economic growth-trade-technological change. The responsibility for creating appropriate conditions for knowledge generation must lie primarily with the developing countries themselves, though the world trading environment could either facilitate or frustrate such attempts. This is an argument for allowing developing countries greater space and independence in policy-making. In particular, it should be recognised that trade policy will continue to play an important role in macroeconomic management as well as in structural transformation of developing economies.

Then there is the matter of the macroeconomic performance of industrial countries, which, along with the trade barriers, is a key determinant of the growth of the developing countries' export earnings. The developing countries can, therefore, hardly be indifferent to the industrial-country policies, but they have little say. At the international level, the surveillance of the macroeconomic policy is primarily the IMF's responsibility. The fact that a number of industrial countries continue to suffer from high unemployment and meagre growth is indicative of the weaknesses of the surveillance system. The developing countries need a forum, paralleling the G-7, in order to address this issue and formulate a common position.

In short, the first order of business is to seek levelling of the playing-field of world commerce and the paper has identified a number of areas. A fairer and equitable environment for competition will ultimately be beneficial for everyone. However, there will still remain the need to give greater attention to the special

circumstances and needs of developing countries that will continue to require preferential treatment not just in matters of trade but also in other areas (notably, finance, access to technology) that bear on development generally.

This matter, in fact, becomes more pressing as markets are liberalised and deregulated, for the simple reason that the benefits from such measures are not equally shared between developing and industrial countries. There can be little doubt that free markets tend to favour the strong against the weak, for this is seen as their basic strength. Market fundamentalism is essentially an ideology, but one that is explicit only with respect to the means—reliance on free markets. But the proponents feel shy of acknowledging that the end-result is to create an environment that is more favourable to the asset-holders, and by implication the industrial North because of their concentration there. The paper has argued for pragmatic, non-ideological policies at national as well as international level. There is certainly a place for ideology, but let it be confined to defining the social, political, or economic agenda rather than prescribing a rigid policy framework to be universally applied, without regard to local conditions.