

# **Taking a Fresh Look at Trade: Creating a Post-Doha Agenda<sup>1</sup>**

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## **An Important Moment**

The collapse of the Doha round of WTO trade negotiations represents an important event. Whereas there have been many significant public protests against the current global trading system – Seattle in 1999, Cancun in 2003 – this is the first full blown collapse of a multilateral trade negotiating round since the 1930s. As such, Doha’s failure creates a momentous opening for repositioning the global trade debate.

## **Why Did Doha Collapse?**

A good starting point for assessing the possibilities for future trade arrangements is to examine why the Doha round collapsed. A first reason is that there appears to be a growing recognition that trade is a complicated phenomenon, and that the simple nostrums of “free trade” and “comparative advantage” do not capture this complexity. In particular, middle-income countries such as Brazil and the rising large developing economies such as India, are increasingly realizing that “Doha-style” agreements potentially compromise their development strategies. This is because these agreements rule out development strategies that favor domestically based production.

Side-by-side, there has been growing anxiety among developed country electorates that Doha-style trade is driving an undesirable form of globalization. This electoral anxiety has provided incentives and created space for political leaders to

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distance themselves from Doha's corporate driven trade agenda. Additionally, developed country agricultural interests, in sectors such as sugar and cotton, were unwilling to give up their existing subsidies and price supports, and used their political muscle to stall Doha.

Finally, NGOs did a particularly good job unmasking the excessive claims about the benefits of further trade liberalization made by the international financial institutions (e.g. the World Bank) and mainstream economists.<sup>2</sup> In this regard, the work of the NGOs was especially useful to developing country governments, who often lack the capacity for their own economic analysis. This time around NGO and activist research provided support for the arguments and positions of developing countries.

### **What now?**

The mainstream press has published much commentary about the threat that Doha's failure poses to the multilateral trading system. The *Financial Times* (April 24, 2006) published a comment by the chairmen of Nokia and BP claiming that "the credibility of the multi-lateral trading system" was at stake and that failure of the round would "leave the trading and investment environment seriously damaged." The *Wall Street Journal* (September 6, 2006) published a comment by British Chancellor of the Exchequer, Gordon Brown, labeling Doha's failure a "Protectionist Backlash." Such commentary misrepresents both the causes and consequences Doha's failure.

Far from signaling a threat to international trade and the global economy, Doha's demise represents a positive opportunity to reposition the global trade debate. Taking advantage of this opportunity will require a twin track strategy. One track will involve

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<sup>2</sup> See for example the report of by Sandra Polaski (2006) of the Carnegie Endowment for International Peace, "Winners and Losers: Impact of the Doha Round on Developing Countries."

developing an affirmative alternative trade agenda that is intellectually coherent and politically compelling. The other must continue exposing the faulty WTO approach to the economics of trade and chipping away at support for the existing policy paradigm. Both are necessary if the opportunity provided by Doha's failure is to be taken advantage of.

A critical element of this new agenda is the need to premise the trade debate on the recognition that trade is a tool and instrument of policy, and not the ultimate goal of policy. The real goals are economic development in the context of a fair, inclusive and politically acceptable globalization. In future, these goals must frame the trade debate and trade must serve them. That means abandoning the current "trade for trade's sake" approach to policy -- an approach epitomized in the metaphor coined by Fred Bergsten, Director of the Institute for International Economics, of the global trade regime as a bicycle that would fall over if the Doha round failed and further trade liberalization stalled.

#### *Challenging the current WTO agenda*

With regard to challenging the current WTO agenda, it is critical to continue exposing the failings of the neo-liberal model of economic development that underlies that agenda. The neo-liberal model is appealingly simple with its assertion of a "one size fits all" approach to policy whereby its recommendations fit all countries regardless of stage of development. Moreover, these policy recommendations are supposedly good for all in the sense of always generating win – win outcomes. Thus, if a country follows a simple set of policies, which include WTO-styled trade policies, the country and the global economy will benefit. This simplicity means the neo-liberal model continues to have an appeal that pulls policy in undesirable directions.

One approach to challenging the model is empirical. Thus, the economic record shows that the neo-liberal policy mix has not delivered, as instanced by Latin America that applied the neo-liberal Washington Consensus most carefully and yet grew more slowly in the post-1980 Washington consensus era (Ocampo, 2002). A second empirical challenge concerns the evidence regarding the relationship between trade and development. For instance, detailed statistical work by Rodrik and Fernandez (2001) challenges the hypothesis that international trade causes development, and instead suggests that countries that develop successfully become successful traders.

Another form of challenge concerns the estimation of the size of the welfare gains to be had from further WTO-styled trade liberalizations. An important element in Doha's demise was alternative model simulations showing that Doha style trade produced relatively small global economic gains even when estimated using economic models constructed to produce gains from trade by assumption. Moreover, what gains there were accrued to the developed country bloc, and the gains were approximately zero for developing countries as a whole. There were also many significant net losers at the individual developing country level (Polaski, 2006).

A third form of challenge concerns the economic theory that has been used to justify and drive the WTO's trade liberalization agenda. That trade agenda is justified by appeal to the classical theory of free trade predicated upon the logic of comparative advantage. However, classical comparative advantage theory no longer captures what is happening in the global economy. Trade driven by global outsourcing is no longer a simple matter of balanced exchange based on comparative advantage, but instead also involves wage arbitrage, changing the balance of economic power between labor and

capital, and changing the character of global competition (Palley, 2006a).

Moreover, in today's world in which technology and methods of production are highly mobile, winning at trade involves strategic policy - including tariffs and exchange rate policy. In such an environment classical free trade is not the best way to develop, and this is now being confirmed by new theoretical developments (Gomory and Baumol, 2000; Samuelson, 2004; Palley, 2006b). History also confirms that free trade has not been the chosen path of development, and that today's industrialized countries – including the U.S. – did not pursue free trade in the early stages of their development (Chang, 2002). Finally, it is noteworthy that the IMF has recently retreated from its earlier automatic predisposition to capital market openness (trade in money). At this stage, it is time to retreat from the automatic predisposition for goods and service market openness. Like capital market openness, the merits of goods and services openness depends on a country's stage of development and the rules governing global trade.

Lastly, it is important not to be deceived by proposals calling for augmenting the Doha trade agenda with a new domestic policy agenda that includes wage insurance (Kletzer and Rosen, 2005). Such wage insurance aims to compensate workers who lose their jobs and end up with lower wages because of trade-induced job loss, and it is welcome as it helps reduce economic risk and improve social well-being. Indeed, such insurance should be expanded to cover wider causes of job loss. However, wage insurance does nothing to address the fundamental failings of the current trade policy regime that are based on faulty economic logic. For this reason wage insurance is not a solution to the trade problem, and the only solution is a new trade regime.

*An affirmative new agenda*

Theoretical critiques of today's dominant trade paradigm in turn pave the way for an affirmative new trade agenda. Once again it must be emphasized that new agenda must serve economic development and promote fair, inclusive, politically acceptable globalization. The notion of incremental trade liberalization suggests the idea of a tropical products trade round, involving commodities such as sugar, cotton, coffee, cocoa, rice, and orange juice (Palley, 2006c). Such a round could focus on those commodities that most benefit developing countries and where Northern subsidies are most damaging. For these commodities, trade predicated upon the theory of comparative advantage still applies, and there are gains from trade to be had by all sides.

The advantages of such a tropical products round are numerous. First, it would show that those who opposed the Doha round are not opposed to trade. Second, the tropics contain the world's poorest countries, and a tropical products round would truly help them. Doha's agricultural liberalization did not help tropical countries because they are significant importers of northern agricultural products (cereals, meat, dairy), and the elimination of northern subsidies under Doha would have raised world prices of those products to the detriment of the south. A tropical products round would reduce northern production of products (cotton, sugar, etc) that compete with the south, so that any induced price increases would raise southern incomes to the benefit of the south.

There are also good economic reasons for northern countries to support such a round. First, there would be large budget savings to taxpayers from elimination of certain specific agricultural subsidies. Second, consumers would gain as prices would come down from elimination of quotas. Third, northern labor would have no interest in opposing a tropical products round as workers would benefit as consumers and taxpayers,

while manufacturing would be off the table. Nor would northern industrialists be hurt, and the most they could claim is that this would be a missed opportunity for other (contested) forms of liberalization that they favor. Fourth, northern production of tropical products is often environmentally damaging, as exemplified by the impact of sugar cane growing on Florida's everglades. Finally, Northern producers of tropical products are politically poorly positioned, as they tend to be large agro-businesses whose political profile is unappealing. This contrasts with confronting subsidies for dairy and grain farming, which have a different political profile that includes small family farmers.

Another element of a post-Doha agenda is that it must purposefully allow developing countries to use tariffs as part of their economic development policy toolbox. For many developing countries tariffs are a significant and efficient source of government. These revenues are needed to fund public investment and public services that are vital for development and vital for ensuring that development serves all. They are an efficient source of finance because tariffs are relatively easy to collect since imported goods are closely tracked and enter through a limited number of ports of entry, and at the same time developing countries usually lack the administrative capacity to tax domestic incomes and expenditures in the way that developing countries do.

Beyond this public finance motive, tariffs have historically proven to be a valuable tool for promoting growth. First, they offer a leg-up to domestic producers so that these producers can learn to compete. Second, they provide an incentive for multinational corporations to produce within a country's borders to avoid the tariff penalty imposed on imported production. These positive impacts are confirmed by the historical record, which shows there was a positive correlation between growth and tariffs

in the 19<sup>th</sup> century (O'Rourke, 2000).

Finally, as part of the re-evaluation of tariffs, it is worth reviving and emphasizing the distinction between tariffs on imported consumption goods versus tariffs on imported capital goods. The latter are an input into production so that capital goods tariffs make a country less competitive and hinder development. This suggests that the policy focus should be on consumption good tariffs. Additionally, to the extent that imported consumption goods are luxury goods, this lends a progressive income redistribution dimension to tariffs.

A third element of a post-Doha agenda is that it should fit in with new thinking about economic development. Over the last two decades economic policy has focused on international trade and growing the supply-side, but it has neglected the development of domestic demand (Palley, 2002, 2006d). The failure to attend to domestic demand considerations has likely slowed growth and made it more unequal. With attention focused on international competitiveness, there has been a focus on holding down costs, and therefore wages. Additionally, the focus on international competitiveness has also encouraged retrograde competition, as countries have tried to win international competitive advantage by whatever means possible. Finally, the focus on international competitiveness has contributed to destabilizing deflationary conditions in the global economy since countries have added to global supply through export-led growth without adding similarly to global demand (Blecker and Razmi, 2005; Palley, 2003). These failings suggest that policy must be repositioned so that it also focuses on developing the demand side.

Developing the demand side in turn leads to a more inclusive agenda. Rather than

simply being a cost, wage income becomes a critical source of demand. Linking wages to productivity can then promote a virtuous circle of inclusive development. Higher productivity drives higher wages, which in turn increase demand to absorb the increase in productivity. At the same time, robust demand conditions encourage producers to invest, further raising productivity and advancing development.

Labor standards are key for such a demand-led model of development as they help workers bargain for a fair share of productivity (Palley, 2004, 2005). This points to the vital need for making labor standards part of the rules of the global trading system. In a global economy, in which countries are pitted against each other through the activities of multi-national corporations and through global sourcing networks, labor standards are critical for establishing a floor for the global economy.

Historically, such standards have been represented as a means of protecting northern workers from competition from exploited southern workers. However, this misrepresents the reality. Wage differences between north and south are so large that labor standards cannot significantly alter this southern advantage. However, what they can do is help prevent unfair wage erosion in the north, thereby actually maintaining wage differentials. Additionally, they can help southern workers capture a larger share of income, thereby promoting domestic demand growth in the global south that spurs inclusive economic development. Over the last twenty years, innovations such as global sourcing have increasingly pitted southern workers against each other in ever-fiercer competition. This has resulted in more value in the global value chain being shifted to northern economies, where it is captured by companies such as Nike and Gap.<sup>3</sup> Labor

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<sup>3</sup> Gereffi (1994) provides a seminal analysis of global value chains and how the global sourcing strategies of U.S. retailers have shaped the distribution of value in the global economy. Also see Hamilton (2005).

standards are a means of mitigating south – south worker competition, thereby enabling the south to capture more of the value generated.

Not only do labor standards yield significant conventional economic benefits for developing countries and the global economy, they also yield significant political benefits being strongly positively associated with democracy (Palley, 2005). Democracy, along with higher incomes, can be viewed as a goal of development, and labor standards therefore promote both goals.

Poor governance is increasingly viewed as a significant obstacle to development, and to the extent that democracy improves governance, democracy is both a means and end of development. A perennial problem in developing countries is the problem of “who will guard the guardians?” Giving policymakers the space to conduct policy can be dangerous if policymakers cannot be trusted. Free traders often assert that free trade is a two-for-one. That is it improves efficiency and raises income, and it also guards the guardians by increasing competition and competing away rents. Labor standards are also a two-for-one in that they promote economic development, and they too guard the guardians by promoting democracy.

Achieving global labor and environmental standards is the great challenge of the 21<sup>st</sup> century. Labor standards are both a “means” and an “end”. They are a means because they contribute to economic efficiency and a structure of income distribution that advances development, and they are end because they promote respect at work and broader political freedom. Linking trade with standards, can ensure that trade serves to promote development and a globalization that is fair, just, and politically acceptable. The charge that labor standards are a form of surrogate “northern protection” is a “divide and

rule” tactic that is without intellectual substance.

Labor standards are the bedrock of any significant constructive re-positioning of the post-Doha trade debate and fashioning an alternative globalization. Moving the labor standards agenda will require a multi-faceted approach. At the national level, trade negotiators should make labor standards an official policy priority to be pushed in all multi-lateral and regional forums. Labor standards should also be included in bi-lateral trade arrangements, and multi-lateral progress can be advanced by building up a core of countries that have signed on for labor standards at the bi-lateral level. Allowable trade preferences, in the form of tariff and quota relief, can also be used as a carrot to induce developing countries to sign on to the labor standards agenda. Most importantly, there is need to change the climate of opinion and understandings about labor standards, and build a global echo chamber supporting such standards. That means the IMF and World Bank, with their massive networks of economists and public opinion outreach, must come on board and endorse labor standards with vigor and openness. Finally, NGOs have an important role to play in this process by directly advocating labor standards and pushing governments and the multilateral institutions to make labor standards part of the rules of the global economy.

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