Fair Trade

Joseph E. Stiglitz

IT HAS become commonplace for politicians of both political parties to trot out rhetoric about how we need free-but-fair trade. Expanding markets through trade liberalization, it is urged, is a win-win situation. How is it, then, that in spite of assertions that *everyone* benefits from trade, there is so much opposition, in both developed and developing countries? Is it that populists have so misled ordinary citizens that, though they are really better-off, they have come to believe they are doing worse?

Or is it because trade liberalization has, in fact, made many people worse off, in developed and developing countries alike? Not only can low-skilled American workers lose their jobs or be paid less, those in developing countries suffer, too. They end up having to take the short end of the stick time and time again in trade agreements because they have little leverage over the big boys. And the links between trade liberalization and growth are far weaker than liberalization advocates claim.

A closer look at both data and standard economic theory provides further insight into the strength of the opposition to trade liberalization. In most countries around the world, there is growing inequality. In the United States, not only is there a steady uptick in poverty, but median household income has been falling for at least eight years. There are many factors contributing to these changes: technology, weakening of social mores, labor unions and, lest we forget, trade liberalization. More than sixty years ago, prominent economists Paul Samuelson and Wolfgang Stolper explained that trade liberalization in high-income countries would lower wages of unskilled workers. The economists showed that even a movement toward free trade brought wages of unskilled workers around the world closer together, meaning, for example, that America's unskilled workers' pay would fall toward that of India and China. Although their model stems from the mid-twentieth century, some of its assumptions hold even more true today. In particular, globalization has greatly reduced disparities in knowledge and technology between the developed and developing world. Lower-paid workers in the developing world now often have the tools, and increasingly, even the education, to perform the same tasks as their counterparts in developed countries. American workers simply get paid more to do the same task. Quite obviously, this can hurt even the higher-paid skilled American worker.

More generally, *standard* economic theory does not say that everyone will be better-off as a result of trade liberalization, only that the winners *could* compen-

Joseph E. Stiglitz is University Professor at Columbia University. He served as the chief economist of the World Bank from 1997 to 2000. He is the author of *Making Globalization Work* (W. W. Norton, 2006), and most recently, with Linda Bilmes of Harvard's Kennedy School, *The Three Trillion Dollar War: The True Costs of the Iraq Conflict* (W. W. Norton, 2008).

sate the losers. They could take a portion of their gains, give it to the losers and *everyone* could be better-off. But, of course, the winners, which in much of America are the very well-off, haven't compensated the losers; indeed, some have been arguing that to compete in the new world of globalization requires cutbacks in government spending, including programs for the poor. The losers then lose doubly.

These results of traditional economic theory are based on assumptions like perfect information, perfect-risk markets, perfect competition and no innovation. But, of course, we do not live in such a perfect world. Modern economic theory has shown that in the imperfect world in which we live, trade liberalization can actually make *everyone* worse off. For instance, trade liberalization may expose individuals and firms to more risk. In the absence of adequate insurance markets, firms respond by shifting production away from high-return risky activities to safer, but lower-return areas, thereby lowering national income.

Careful studies have found, at best, weak links between trade liberalization and growth. Many studies do show that countries that have increased their levels of trade—China is a good example—have grown faster. But these countries did not liberalize in their earlier stages of development. They promoted exports and restricted imports. And this export promotion worked.

A standard argument for reducing tariffs is that it allows resources, especially labor, to move from lower-productivity sectors into higher-productivity ones. But all too often, it results in moving workers from low-productivity employment into zero-productivity unemployment. For example, workers in Jamaica's dairy industry cannot compete with America's highly subsidized milk exports, so when Jamaica liberalized, opening up its markets to these subsidized imports, its dairies were put out of business. But the dairy workers didn't automatically get reemployed elsewhere. Rather, they simply added to the already-high unemployment rolls. In many countries, where there is high unemployment, there is no need to "release" resources to expand exports. There are a variety of impediments to expanding exports—including internal barriers to trade (such as the absence of infrastructure, which highlights the need for aid-for-trade) and, on an even-more-basic level, the absence of capital. Ironically, under today's rules, trade liberalization may again make matters worse. That is because countries are being forced to open up their markets to foreign banks, which are more interested in lending to multinationals and national monopolies than to local small- and medium-sized businesses, the sources of job creation.

Waxing Politic

THE CASE for trade liberalization is far weaker than most economists will admit. Those who are more honest fall back on political arguments: it is not that trade liberalization is such a good thing; it is that protectionism is such a bad thing. Inevitably, it is argued, special interests prevail. But in fact, most successful economies have evolved with at least some protection of new industries at critical stages of their development. In recent work, my colleague from Columbia University, Bruce Greenwald, and I have built on that idea by developing an "infant-economy argu-

ment" that looks at how using protection as countries grow can encourage the industrial sector—the sector most amenable to learning and technological progress. The benefits of that support then diffuse throughout the economy. Such policies do not require governments to "pick winners," to identify which particular industries are well suited to the country. These policies are based on a recognition that markets do not always work well, particularly when there are externalities, where actions in one part of the economy affect another. That there are huge spillovers from successful innovation is incontrovertible.

Politicians, of course, are not constrained by economics and economic logic. Even if we see in our model that safeguarding nascent sectors is the best way to support economic growth, trade advocates claim, for instance, that trade creates jobs. But exports create jobs; imports destroy them. If one justified trade liberalization on the basis of job creation, one would have to support export expansion but simultaneously advocate import restrictions—these days, typically through nontariff barriers called dumping and countervailing duties. This is the curious position taken by many politicians who *say* they favor free trade. George W. Bush, for instance, while bandying about terms such as free trade and free markets, imposed steel tariffs at a prohibitive level even against desperately poor and tiny Moldova. This in spite of the fact that Moldova was struggling to make the transition from communism to a market economy. American steel producers could not compete and demanded these kinds of tariffs—they couldn't compete, not because of unfair competition from abroad, but rather because of failed management at home. In this case, eventually the World Trade Organization (WTO) ruled against the United States, and this time, the United States complied.

The important point missed by these politicians—and the economists who serve them ill by using such arguments—is that trade is not about job creation. Maintaining the economy at full employment is the responsibility of monetary and fiscal policies. When they fail—as they have now done once again—unemployment increases, *whatever the trade regime*. In reality, trade is about standards of living. And that raises an important question: whose standards of living, exactly?

Double Standards

IN DEVELOPING countries, there is another set of arguments against the kind of trade liberalization we have today. The so-called free-trade agreements being pushed by the Bush administration are, of course, not free-trade agreements at all. If they were, they would be a few pages long—with each party agreeing to eliminate its tariffs, nontariff barriers and subsidies. In fact, they go on for hundreds of pages. They are *managed*-trade agreements—typically managed for the special interests in the advanced industrial countries (especially those that make large campaign contributions, like the drug industry). The United States keeps its agricultural subsidies, and developing countries are not allowed to impose countervailing duties. And the agreements typically go well beyond trade, including investment agreements and intellectual-property provisions.

These investment agreements do far

more than just protect against expropriation. In a perfect show of how all of this is supporting the developed countries while hurting the developing, they may even give American firms operating overseas protections that American firms operating domestically do not have—such as against loss of profits from new regulations. They represent a step backward in creating a rule of law: disputes are adjudicated in processes that fall far short of the standards that we expect of others, let alone of ourselves. Even worse, the ambiguous provisions can put countries in crisis in an impossible bind. They have given rise to large lawsuits, forcing developing countries to pay out hundreds of millions of dollars. In a particularly egregious example, Indonesia was forced to pay compensation for profits lost when it abrogated an almost-surely corrupt contract that then-President Suharto signed. Even though the abrogation of the agreement took place when Indonesia was falling into crisis and receiving support from the International Monetary Fund, the country was still held responsible for repayment of *anticipated* profits, which were unconscionably large because of the very corruption that many believe contributed to the country's problems in the first place.

In addition, beyond the terms of the investment agreements, the intellectual-property provisions, too, are onerous on developing countries. In fact, the intellectual-property-rights regime that is being foisted on developing countries is not only bad for developing countries; it is not good for American science and not good for global science. What separates developed from less-developed countries is not only a gap in resources but a gap in knowledge. The intellectual-property provisions reduce access to knowledge, making it more difficult to close the knowledge gap. And even beyond their impact on development, the provisions make it more difficult for developing countries to gain access to lifesaving medicines by making it harder for them to obtain generic drugs, which sell for a fraction of the price of the brand-name ones. The poor simply cannot afford brand-name prices. And because they cannot afford these prices, thousands will needlessly die. At the same time, while the drug companies demand these high prices, they spend little on the diseases that afflict the poor. This is hardly surprising: the drug companies focus on profits; one of the problems of being poor is that you have no money—including no money to buy drugs. Meanwhile, the drug companies have been reluctant to compensate the developing countries adequately for the genetic material that they obtain from them that often provides the basis of new drugs; and the intellectual-property regimes almost never provide any protection for developing countries' traditional knowledge, giving rise to worries about biopiracy. The United States, for instance, granted patents for basmati rice (which had been consumed in India for generations), for the healing properties of turmeric and for many uses of neem oil. Had India recognized and enforced these patents, it would have meant, for instance, that every time an Indian had eaten his traditional staple basmati rice, or used turmeric for healing an ailment, he would have had to send a check to the United States in payment of royalties.

Recent bilateral trade agreements are,

of course, even worse in many respects than the earlier multilateral ones: how could one expect a developing country to have much bargaining power when negotiating with the United States? As several trade negotiators have told me bluntly, the United States demands, and they either take it or leave it. The United States says, if we make a concession for you, we would have to make it for everyone. In addition, not only does the array of bilateral and regional agreements undermine the multilateral trading system, but it also weakens market economics, as countries must look not for the cheapest inputs, but for the cheapest inputs satisfying the rules of origin. A Mexican apparel firm might be able to produce shirts more cheaply using Chinese buttons, but if he turns to the lowest-cost provider, his shirt will no longer be considered sufficiently "Mexican" to warrant duty-free access to the United States. Thus, the bilateral trade agreements actually impede global trade.

In both the multilateral and bilateral agreements, there has been more of a focus on liberalization and protection of capital than of labor; the asymmetry alters the bargaining power of labor versus capital because firms threaten that if the workers don't accept wage cuts, they will move elsewhere, contributing to the growing inequality around the world.

The cards are stacked against the developing countries in other ways as well. The WTO was a step in the right direction, creating an international rule of law in trade; even an unfair rule of law may be better than no rule of law at all, where the big countries can use their economic muscle without constraints. But the legal process is expensive, and this puts poor countries at a disadvantage. And even when they win, there is little assurance of compliance. Antigua won a big case against the United States, but has no effective way of enforcing its victory. The WTO has ruled that American cotton subsidies are illegal, yet the United States continues to provide them—twenty-five thousand rich American farmers benefit at the expense of millions of very poor people in the developing world. It is America's and Europe's refusal to do anything about their agricultural subsidies, more than anything else, that has stalled the so-called Doha Development Round.

But even in its conception, the Doha Development Round was a development round in name only; it was an attempt by the developed countries to put old wine into new bottles while hoping the developing countries wouldn't notice. But they did. A true development round—a trade regime that would promote development—would look markedly different.[1] It would, for instance, allow freer movement of labor—the global gains from labor-market liberalization are in fact much greater than from the liberalization of capital. It would eliminate agricultural subsidies. It would reduce the nontariff barriers, which have taken on increasing importance as tariff barriers have come down. What the trade ministers from the advanced industrial countries are trying to sell as a development round looks nothing like what a true development round would look like.

Trade Agreements and America's National Interest

THE GAP between American free-trade rhetoric and the unfair managed-trade reality is easily exploited by the critics of markets and of America. It provides an all-too-easy target. In some countries, America's trade agreements have helped promote democracy: citizens have been so aroused by America's unfair bilateral trade agreements that they have activated civil society, uniting dispa-

[1]In my book with Andrew Charlton, *Fair Trade for All* (Cambridge: Oxford University Press, 2005), we describe in more detail what this regime would look like.

rate groups to work in unison to protest against the United States. The reason we wanted a trade agreement with Morocco was not because of the importance of our trade relations but because we wanted to build better relations with a moderate Arab country. Yet, by the time the U.S. trade representative put forth his largely nonnegotiable demands, the country had seen its largest street protests in years. If building goodwill was the intent of this and other trade agreements, the effect has been, at least in many cases, just the opposite.

None of this is inevitable. We could easily manage trade liberalization in a way in which there are more winners and fewer losers. But it is not automatic, and it is not easy. We have to devise better ways of safeguarding the losers—we need social protections, not protectionism. To take but one example: America is one of the few advanced industrial countries where there is reliance on employment-related health insurance, and it has, at the same time, a poor unemployment-insurance system. A worker who loses his job, whether as a result of foreign competition or technological change, loses his health insurance; and the paltry sums he gets in unemployment insurance make private purchase unaffordable for most. It is understandable why Americans are worried about losing their jobs as the economy slips into recession. But with most Americans today worse off than they were eight years ago, this recession is beginning even before fully recovering from the last; Americans are seeing their life savings being wiped away by the ever-declining price of housing (their one and only asset). It provides these Americans little comfort to know that someone making more than $100,000 a year, who has just gotten big tax breaks in 2001 and again in 2003, may be better-off as a result of trade liberalization. Vague promises that in the long run they, too, will be better-off provide little comfort—as Keynes quipped, "in the long run we are all dead." The median American male in his thirties has a lower income today than his counterpart thirty years ago. Trade may not have been the only reason for the decline, or even the most important one, but it has been part of the story. Individuals can't do anything about technology; they can do something about trade. If there are benefits from trade and the winners want to sustain support for trade liberalization, they must be willing to share more of the gains with the losers.

If more developing countries are to benefit more from trade liberalization, we need a fairer trade regime; and if more people are to benefit from trade liberalization, we need to manage trade liberalization better. The United States should move toward a more comprehensive agenda for fairer trade and better-managed trade liberalization.[2] This agenda will ensure that the fruits of trade are shared by both the poor and the rich, in both the developing and developed countries. Without it, we should not be surprised about the backlash we are seeing, both in the United States and abroad. □

---

[2] I explain this agenda further in my book *Making Globalization Work* (New York: W. W. Norton, 2006).