Trade POLICY Report 18

The Political Economy of Trade Liberalisation

What Lessons for Reforms Today?

by Razeen Sally

The South African Institute of International Affairs

SAIIA

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Razeen Sally's research focuses on trade policy in Asia, the WTO and preferential trade agreements. He also writes on the intellectual history of political economy, especially the theory of commercial policy. He lectures and consults on trade policy for governments, business and international organisations, and comments regularly on international economic policy issues in the media.

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INTRODUCTION

This paper provides an overview of trade policy reforms in developing countries, especially the acceleration of trade and foreign investment liberalisation since the early 1980s. Its accent is on political economy, drawing on country examples and comparisons to show how politics interacted with economic conditions and shaped the relative success or otherwise of reforms. This exercise is intended to shed light on the prospects for further external liberalisation in current conditions, at a time when the 'Washington Consensus' attracts greater scepticism than it did in the 1980s and 1990s, and when the momentum of liberalisation has slowed down. The paper will answer the following questions: How necessary is further liberalisation of trade and foreign direct investment (FDI)? What obstacles lie in its path? What are its political requisites? What are the links with domestic economic reforms? What is the balance between unilateral liberalisation and reciprocity (liberalisation through trade negotiations and agreements with donors)? Particular attention is given to the political economy of unilateral liberalisation.

The first section of the paper sets the scene by looking at the global climate for external liberalisation, including debates revolving around the Washington Consensus. Section 2 reviews the record of trade and FDI liberalisation across the developing world. Section 3 probes the political economy of trade policy reforms. It provides a classification of the main factors influencing policy reforms, and makes comparisons across countries and regions. Section 4 looks at 'multi-track' trade policy, i.e. trade policy conducted, often simultaneously, on unilateral, bilateral, regional and multilateral tracks. Section 5 sets out lessons for future liberalisation in developing countries.

1. THE GLOBAL CLIMATE FOR EXTERNAL LIBERALISATION

To expect, indeed, that the freedom of trade should ever be entirely restored ... is as absurd as to expect that an Oceana or Utopia should ever be established ... Not only the prejudices of the publick, but what is much more unconquerable, the private interests of many individuals, irresistibly oppose it.

Adam Smith, *Wealth of Nations*

There is less appetite for further liberalisation and associated structural reforms now compared with the heyday of the Washington Consensus in the 1980s and 1990s. Reforms have not been reversed, but their forward momentum has slowed. Governments are more sceptical and defensive about further liberalisation, and there has been relatively little in the way of 'second-generation' reforms (in domestic trade-related regulations and institutions) to underpin external liberalisation and boost competition.

This applies to the West, and to most developing-country regions. In the developed world, pervasive agricultural protectionism continues, with an admixture of new protectionism directed against China. The West has no *grand project* for liberalisation in the early 21st century to compare with the Reagan and Thatcher reforms in the 1980s, or the Single Market programme of the European Union (EU) in the late 1980s and early 1990s. Eastern European countries are suffering from 'reform fatigue' after their accession to the EU. This is also the state of play in much of Latin America, Africa, South Asia and South-East Asia; and it is true of leading developing countries, notably Brazil, Mexico, South Africa and India. All have their real bursts of trade and FDI liberalisation behind them. In Russia, liberalisation has been put into reverse gear. This has also happened in other resource-rich countries enjoying a revenue windfall, e.g. Venezuela and Bolivia. Overall, protectionist flare-ups and lack of reform momentum in the West have reinforced liberalisation slowdown outside the West.

China is the conspicuous exception: liberalisation proceeded apace before and after World Trade organisation (WTO) accession, in what has been the biggest opening of an economy the world has ever seen. However, domestic political conditions for further liberalisation are now more difficult. Vietnam has followed in China's tracks, with internal and external liberalisation accelerating in the run-up to its WTO accession in 2006.

A variety of factors accounts for liberalisation scepticism today. There is much anxiety about globalisation, despite record growth across the world in the last five years. Macroeconomic crises provided windows of opportunity for fast and furious liberalisation in the 1980s and 1990s, but that has not happened since the Asian and other financial crises of the late 1990s. Indeed, the latter may have brought about a popular backlash, and certainly induced more caution regarding further liberalisation. Also, further liberalisation entails tackling border and, increasingly, domestic regulatory barriers in politically sensitive areas such as agriculture and services. Inevitably, this runs up against more powerful interest group opposition than was the case with previous waves of (mainly industrial goods) liberalisation. Individuals matter too: the new century has not yet brought forth a Cobden, Gladstone, Erhard, Thatcher or Reagan to champion free markets or free trade.

Not least, the climate of ideas has changed, for prevailing economic 'weather conditions' have become more inclement since the Washington Consensus reached its zenith only a decade ago. There is, now as before, an extreme anti-globalisation critique, a root-and-branch rejection of capitalism. But this is street theatre on the fringe. Of greater political importance is a more mainstream critique that accepts the reality of the market economy and globalisation, but rejects the comprehensive liberalisation associated (perhaps unfairly) with the Washington Consensus.

Critics point to tenuous links among liberalisation, openness, growth and poverty reduction; wider inequalities within and between countries that result from globalisation; the damaging effects of large and sudden trade liberalisation in developing countries; the renewed emphasis on aid to poorer developing countries, without which trade liberalisation will not work; the need for developed-country liberalisation while retaining developing-country protectionism; and the need for more flexible international rules to allow developing-country governments to pursue selective industrial policies, especially to promote infant industries.[1] Lastly, there is the pervasive fear – in the South as much as in the North – of being run over by an unstoppable Chinese export juggernaut.

It is important to confront the liberalisation sceptics and industrial interventionists head on; to defend liberalisation to date, while accepting that its record is mixed; to make the case for further liberalisation; and to identify the political conditions that might make it succeed. Protectionism and industrial

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1 Stiglitz J, *Globalisation and Its Discontents*. London: Allen Lane, 2002; Rodrik D, *The New Global Economy and Developing Countries: Making Openness Work*. Washington, DC: Overseas Development Council, 1998; Rodrik D, 'Trading in illusions', Foreign Policy, March/April 2001, http://www.foreignpolicy.com/issue_marapr_2001/rodrick.html; Oxfam, Rigged Rules and Double Standards: Trade, Globalisation and the Fight against Poverty. Oxford: Oxfam International, 2002, http://www.maketradefair.com; Chang H-J, *Kicking away the Ladder: Development Strategy in Historical Perspective*. London: Anthem Press, 2002; Grunberg I, I Kaul & M Stern (eds), *Global Public Goods: International Co-operation in the 21st Century*. New York & Oxford: Oxford University Press, 1999; Sachs J, *The End of Poverty: How We Can Make It Happen in Our Lifetime*. London: Penguin, 2005.

policy intervention has mostly failed across the developing world: history, not just theory, should be a warning not to go down this route again.

Firstly, in-depth country studies by the Organisation of Economic Cooperation and Development (OECD), the National Bureau of Economic Research and the World Bank, going back to the 1970s and 1980s, suggest strongly that countries with more liberal trade policies have more open economies and grow faster than those with more protectionist policies. These are much more reliable than superficial cross-country regression analyses.[2] That said, even most of the latter point to large gains from trade liberalisation.[3]

Putting together calculations done by the World Bank and Angus Maddison, a snapshot of the developing world in the year 2000 reveals the following. There are about 25 'new-globalising' developing countries (the World Bank's term), with a total population of about three billion people. Since 1980, this group registered massive increases in their trade-to-gross domestic product (GDP) ratios and real per capita incomes, alongside big cuts in levels of tariff protection. In the same period, over 50 'less-globalised' developing countries, with a combined population of about 1.5 billion, saw stagnant trade-to-GDP ratios and a modest increase in real per capita incomes, alongside relatively modest cuts in average import tariffs. The – overwhelmingly Asian – new globalisers have also seen dramatic reductions in poverty and improvements in human welfare indicators (such as adult literacy, infant mortality, life expectancy and nutritional intake).[4]

Secondly, it is not true that globalisation 'excludes' certain developing countries. Rather, globalisation provides an enabling environment that some countries have taken advantage of and others have not. New globalisers in East Asia, South Asia (first Sri Lanka, and now India), Central and Eastern Europe,

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2 Bhagwati J & TN Srinivasan, 'Outward-orientation and development: Are revisionists right?', *Yale University Economic Growth Center Discussion Paper* No. 806, 17 September 1999; Lal D & H Myint, *The Political Economy of Poverty, Equity and Growth: A Comparative Study*. Oxford: Clarendon Press, 1996.

3 For example, Sachs J & A Warner, 'Economic reform and the process of global integration', *Brookings Papers on Economic Activity* No. 1, 1995; Winters LA, 'Trade liberalisation and economic performance: An overview', *Economic Journal*, February 2004; Winters LA et al., 'Trade liberalisation and poverty', *Journal of Economic Literature*, March 2004.

4 World Bank, *Global Economic Prospects and the Developing Countries: Making Trade Work for the World's Poor*. Washington, DC: World Bank, 2002b, p.34, Table 1.1; Maddison A, *The World Economy: Historical Statistics*. Paris: OECD, 2003.

Latin America (notably Chile) and elsewhere have reaped the benefits through more market-oriented policies and institutions. They are narrowing the wealth gap with the West. This is why global poverty has been massively reduced (especially as a percentage of world population, and even in absolute numbers, despite a growing world population). Political disorder, macroeconomic instability, insecure property rights, rampant government intervention and high external protection have kept other countries 'non-globalised' and thereby retarded growth and development. Most of these countries are cursed with dysfunctional or failed states run by venal, thuggish, even murderous elites. None of this is 'caused' by globalisation.[5]

Thirdly, non-governmental organisations (NGOs) and developing-country governments have been clamouring for one-sided liberalisation in the Doha Round. Their interpretation of 'development' in the Doha Development Agenda is that it behoves developed countries to liberalise in areas that are protected against labour-intensive developing-country exports. But developing countries should not reciprocate with their own liberalisation.[6] What Oxfam and others fail to say is that developing countries' own protectionist policies harm them even more than developed-country barriers. The World Bank estimates that 80% of the developing-country gain from worldwide agricultural liberalisation would come from developing countries' liberalisation of their highly protected agricultural markets. It is unskilled rural labour – the poorest of the poor – who would gain most, as such liberalisation would reduce the anti-agricultural bias in domestic economies.[7]

Fourthly, the historical record is not kind to 'hard' industrial policies of the infant-industry variety. Infant-industry success in the 19th-century USA and Germany is contested. In East Asia, its record is mixed at best in Japan, South Korea and Taiwan; non-existent in free trade Hong Kong and Singapore; and failed in South-East Asia (e.g. national car policies in Malaysia and Indonesia). In North-East Asia, there is scant evidence to show that protection of

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5 Henderson D, 'Globalisation, economic progress and New Millennium Collectivism', *World Economics*, 5, 3, July–September 2004, pp.52–58; Wolf M, *Why Globalisation Works: The Case for the Global Market Economy*. New Haven: Yale University Press, 2004, ch. 9.

6 Oxfam, *op. cit.*

7 Ingco MD & JD Nash (eds), *Agriculture and the WTO: Creating a Trading System for Development*. Washington, DC: World Bank, 2004.

infant industries actually led to higher social rates of return and higher overall productivity growth.[8] South-East Asia's conspicuous success is in FDI-led electronics exports – a result of drastically lower tariffs and an open door to inward investment. China, like South-East Asia, has grown fast through FDI-led exports, not infant-industry protection. Arguably, other factors – political and macroeconomic stability, competitive exchange rates, private property rights, openness to the world economy, education and infrastructure – were much more important to East Asian success than 'picking winners'. Finally, infant-industry protection in Latin America, South Asia and Africa has been a disaster not dissimilar to industrial planning in ex-command economies. Protected infant industries sooner or later ran into severe problems; and governments continued to subsidise and protect perpetual children. Such incestuous government–business links provided a fertile breeding ground for corruption. Besides, most developing-country markets are too small to support infant-industry promotion; and their states are too weak, incompetent and corrupt to efficiently administer the complex instruments required.

Protectionism in the world: Unfinished business

Protectionism remains high around the world, even after six decades of liberalisation, first in developed countries and then in developing countries. There are pockets of developed-country protection – agricultural subsidies, peak tariffs and tariff escalation in agriculture and manufactures, anti-dumping duties, assorted regulatory barriers such as onerous product standards, and high restrictions on the cross-border movement of workers – that continue to damage developing-country growth prospects.

But developing countries' own protection on almost all these counts is much higher and more damaging. Average applied tariffs in developing countries are more than double those in developed countries, with much higher bound rates in the WTO (see Table 1).

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8 Little IMD, 'Trade and industrialisation revisited', in *Collection and Recollections*. Oxford: Clarendon Press, 1999; World Bank, *The East Asian Miracle*. Washington, DC: World Bank, 1993.

Table 1: Bound and applied tariff rates (%), 1998–2004

	Bound		Applied	
	Developed economies	Developing economies	Developed economies	Developing economies
All goods	17.8	43.6	5.5	11.8
Agriculture	24.3	60.6	9.5	16.3
Manufactures	16.7	32.5	4.8	11.0

Note: Developed and developing economies by World Bank definitions. Developed economies: category 3–4 (2002–04), and developing economies: category 1–2 (1998–2004).

Source: World Bank trade databases, http://siteresources.worldbank.org/INTRES/Resources/469232-1107449512766/tar2005a.xls

South Asia, sub-Saharan Africa, the Middle East and North Africa have higher average tariffs than East Asia, Latin America and Eastern Europe (see Table 2).

Table 2: Tariff rates in different regions (%), 1998–2004

Country group or region	Applied	Bound	Agriculture (applied)	Manufactures (applied)
High-income economies	5.5	17.8	10.6	3.3
Latin America and the Caribbean	9.9	41.2	14.9	9.0
East Asia and Pacific	10.5	29.5	16.8	10.5
South Asia	17.8	66.5	19.1	17.2
Europe and Central Asia	7.8	13.2	14.0	6.7
Middle East and North Africa	18.0	34.6	22.5	16.9
Sub-Saharan Africa	13.4	61.5	17.2	12.9

Note: The numbers are unweighted averages for the period. Regional definitions by the World Bank, http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20421402~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html

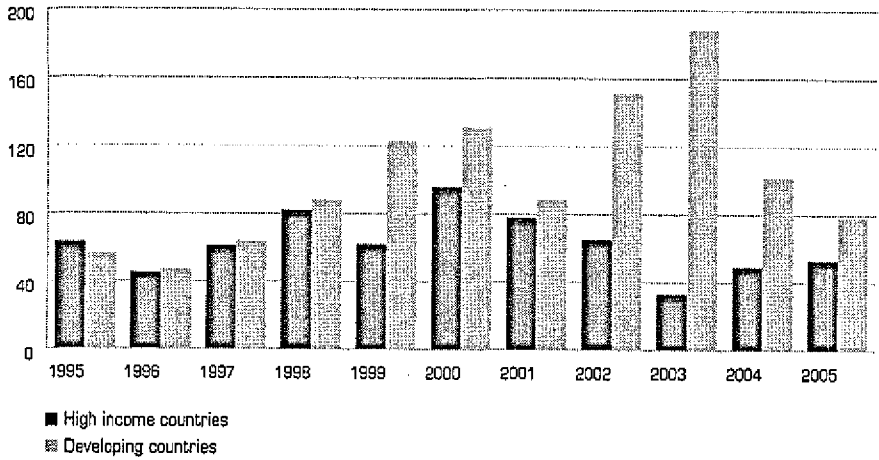
Source: World Bank trade databases, http://siteresources.worldbank.org/INTRES/Resources/469232-1107449512766/tar2005a.xls

Bound and applied tariffs in agriculture are significantly higher than they are in manufactures. Developing countries have become bigger users of anti-dumping actions than developed countries (see Figure 1).

A few developing countries – notably India – have become much more frequent users of anti-dumping actions (see Figure 2).

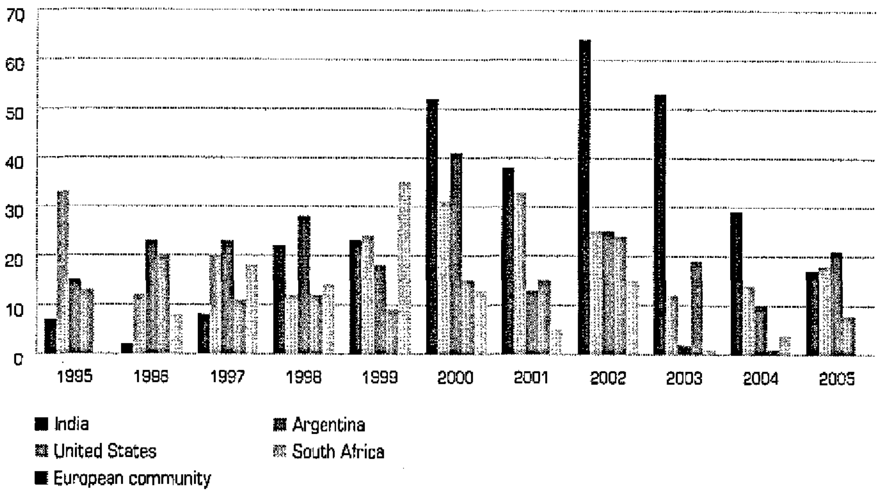
Developing countries, with the exception of countries in transition and those that have recently acceded to the WTO, have far fewer multilateral commitments than developed countries in services (see Figure 3).

Figure 1: Anti-dumping measures, 1995–2005



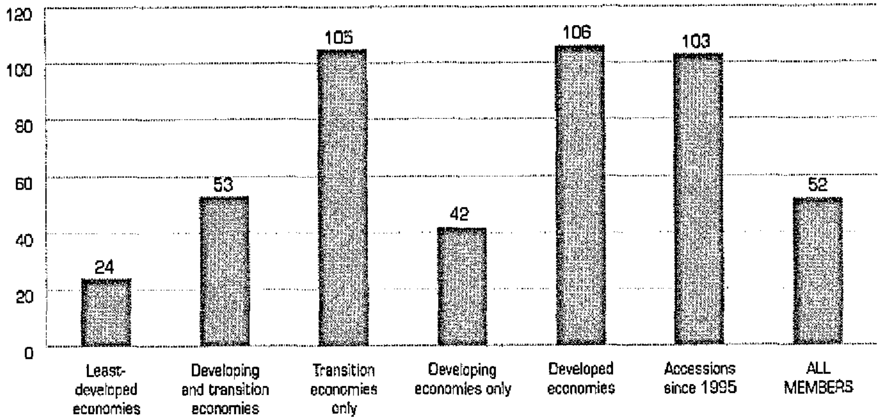
Note: Anti-dumping measures by reporting WTO member. Classification of countries by World Bank definitions
Source: WTO, http://www.wto.org/english/tratop_e/adp_e/adp_stattab7_e.xls

Figure 2: Most frequent users of anti-dumping measures, 1995–2005



Note: Anti-dumping measures by reporting WTO members.
Source: WTO, http://www.wto.org/english/tratop_e/adp_e/adp_stattab7_e.xls

Figure 3: Distribution of GATS* commitments across groups of WTO members, March 2005 (average number of sub-sectors committed per member)



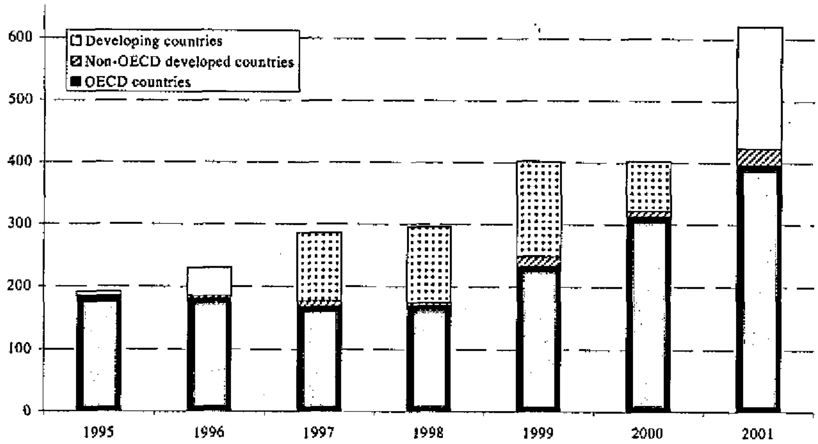
** General Agreement on Trade in Services*

Source: WTO, Staff Working Paper No. ERSD-2005-01, http://www.wto.org/english/res_e/reser_e/ersd200501_e.doc

There has been a general increase in the use of technical, food-safety and other standards that affect trade, as indicated by the number of measures notified under the WTO's technical barriers to trade (TBT) and sanitary and phyto-sanitary standards (SPS) agreements. This is one – admittedly very rough – indication of regulatory barriers to trade. Developed countries account for over half of TBT and SPS measures notified, but what is also striking is the increasing number of measures notified by developing countries (see Figures 4 and 5).

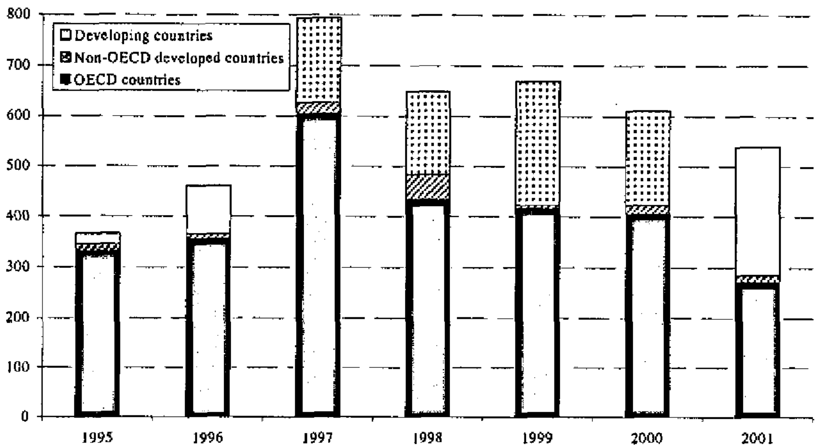
Thus, there is much unfinished business in terms of liberalising trade, capital flows and the cross-border movement of labour in the developing world. That said, external liberalisation is no panacea. In the short run, trade liberalisation reduces the anti-import, anti-export bias of trade taxes. That is the prelude to dynamic gains – including those from trade-related inward investment – that result in productivity improvements and growth. Capturing these gains, however, depends on additional factors: initial conditions for reform, including a country's factor endowments and historical legacy; complementary domestic market-based reforms; and the state of and improvement in domestic institutions. The connection between opening to the world economy and domestic economic and institutional reform is particularly important: it is

Figure 4: Number of notified SPS measures, 1995-2001



Source: OECD, COM/TD/AGR/WP(2002)21/FINAL, http://www.olis.oecd.org/olis/2002doc.nsf/43bb6130e5e86e5fc12569fa005d004c/7b8815fac33fe88ec1256bed002e5cb7/$FILE/JT00129244.PDF

Figure 5: Number of notified TBT measures, 1995-2001



Source: OECD, COM/TD/AGR/WP(2002)70/FINAL, http://www.olis.oecd.org/olis/2002doc.nsf/43bb6130e5e86e5fc12569fa005d004c/baacb7d0229000f9c1256cdf00418c0f/$FILE/JT00140246.PDF

this that explains much of variation in economic performance in the developing world. This is not a new insight: David Hume and Adam Smith strongly linked free trade (broadly defined to include cross-border flows of capital and people) to domestic institutions and growth, all on the canvas of the long-run progress of commercial society.[9] But this also begs difficult political questions. In essence, successful external opening depends crucially on domestic politics and institutional capacity. Here there are very large and arguably increasing differences within the developing world.

2. TRADE POLICY REFORMS: THE RECENT EXPERIENCE, WITH COUNTRY EXAMPLES

Trade liberalisation has several definitions. Trade economists speak of moving to a state of 'neutrality' of government intervention as between tradable and non-tradable sectors of the economy. They also speak of 'getting prices right' by aligning domestic prices with world prices of tradable goods. More broadly conceived, free (or free-ish) trade means the freedom to engage in international transactions, without discrimination.[10] This exists nowhere – not even in Hong Kong, which maintains tight restrictions on immigration, though it is fully open to trade in goods and capital flows, and largely open to trade in services. If non-discrimination is the relevant criterion, all countries are still far from free trade, indeed more so than was the case in the late 19th century.

Nevertheless, there has been a distinct liberalisation trend in developing countries in recent decades.[11] Cross-border trade and capital flows – though not

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9 Sally R, *Classical Liberalism and International Economic Order: Studies in Theory and Intellectual History*. London: Routledge, 1998.

10 Henderson D, 'International economic integration: Progress, prospects and implications', *International Affairs*, 64, 4, 1992, p.635.

11 On the record of trade and FDI liberalisation as part of larger packages of market-based reforms in developing countries and countries in transition, see Williamson J (ed.), *The Political Economy of Policy Reform*. Washington, DC: Institute for International Economics, 1993; Williamson J & P-P Kuczynski (eds), *After the Washington Consensus: Restarting Growth and Reform in Latin America*. Washington, DC: Institute for International Economics, 2004; Lal D & H Myint, *op. cit.*; Dean J, 'The trade-policy revolution in developing countries', The World Economy, Global Trade Policy 1995; Drabek Z & S Laird, 'The new liberalism: Trade-policy developments in emerging markets', Journal of World Trade, 32, 5, 1998, pp.241–69; Henderson D, *The Changing Fortunes of Economic Liberalism: Yesterday, Today and Tomorrow*. London: Institute of Economic Affairs, 1998; Michalopoulos C, Developing Countries and the WTO. London: Palgrave, 2001; Bates R & A Krueger (eds), Political and Economic Interactions in Economic Policy Reform: Evidence from Eight Countries. Cam-

of people – have become freer. There is less discrimination between domestic and international transactions. Domestic prices of tradable goods and services are closer to world prices (though less the case in services than in goods). In terms of measures undertaken, import and export quotas, licences, state trading monopolies and other non-tariff barriers have been drastically reduced. Tariffs have been simplified and reduced. So have foreign exchange controls, with unified exchange rates and much greater currency convertibility, especially on current account transactions. FDI has been liberalised, with fewer restrictions on entry, ownership, establishment and operation in the domestic economy. And services sectors have been opened to international competition through FDI liberalisation, privatisation and domestic deregulation. Overall, trade and FDI in manufactured goods has been liberalised most; trade and FDI in services was liberalised later, and to a much lesser extent; and trade liberalisation in agriculture has lagged behind. Lastly, trade and FDI liberalisation has taken place in the context of wide-ranging macro- and microeconomic market-based reforms – roughly the 'stabilisation and liberalisation' package of the Washington Consensus, as described by John Williamson.[12]

Cumulatively, this has been a veritable policy revolution in developing countries and countries in transition. Before the 1980s, the 80% of the world's population who live outside the West lived overwhelmingly in countries with high levels of external protection, in addition to pervasive government intervention at home. By the mid-1990s, most of these people lived in much more open economies, in terms of both domestic and international commerce.[13] Average applied tariffs in developing countries declined from just below 30% in 1985 to just below 11% in 2005 (see Figure 6).

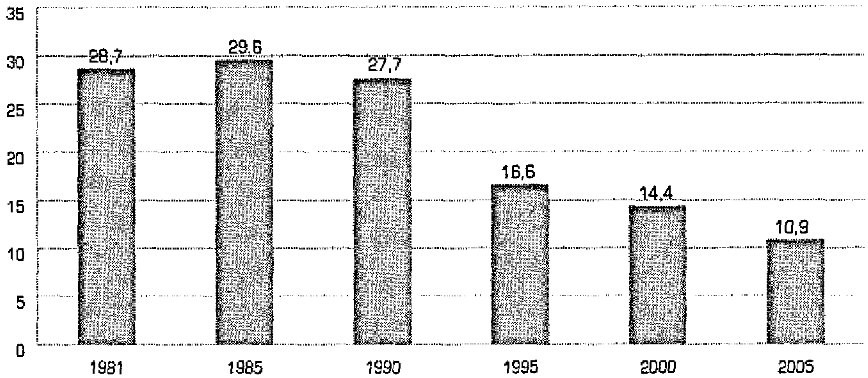
Table 3 shows declining tariffs in Asian countries, while Table 4 shows bound and applied tariffs in selected countries, including those covered in this project.

bridge, Mass.: Blackwell, 1993; Desai P (ed.), *Going Global: Transition from Plan to Market in the World Economy.* Cambridge, Mass.: MIT Press, 1997. On trade policy trends in Asia, see Sally R, 'Trade policy in Asia', ECIPE Policy Brief No. 1, 2007, http://www.ecipe.org/pdf/Policybrief_0107.pdf; Sally R, 'Chinese trade policies in wider Asian perspective', in Yao Y & L Yueh (eds), *Globalisation and Economic Growth in China.* London: World Scientific Publishing, 2006; Sally R & R Sen, 'Whither trade policies in southeast Asia? The wider Asian and global context', ASEAN Economic Bulletin, 22, 1, April 2005, pp.92–115.

12 Williamson J, *op. cit.*

13 Sachs J & A Warner, *op. cit.*

Figure 6: Average applied tariff rates in developing countries (%, unweighted), 1981–2005



Source: World Bank trade databases, http://siteresources.worldbank.org/INTRES/Resources/tar2005.xls

Table 3: Applied tariff rates in Asia (%), 1995 and 2005

	1995	2005
Japan	3.1	2.7
Korea	8.3	8.6
Taiwan	11.2	5.3
Hong Kong	0	0
Singapore	0.4	0
Malaysia	8.4*	7.5
Indonesia	14	6.5
Philippines	19.8	5.4
Thailand	21	9.9
Vietnam	13**	13.1
China	22.4	9
India	41	16

**Malaysia 1996.*
***Vietnam 1997. All tariff rates are based on unweighted averages for all goods in ad valorem rates, or applied rates, or MFN (most favoured nation) rates, whichever data is available over a longer period.*
Source: World Bank trade databases, http://siteresources.worldbank.org/INTRES/Resources/tar2005.xls

Core non-tariff barriers (NTBs) declined correspondingly in all developing-country regions (see Table 5).

The bulk of regulatory changes on inward investment have been more favourable to FDI (see Table 6).

There has even been a trend in favour of capital account liberalisation: 70% of the developing countries in the International Monetary Fund (IMF) maintain

Table 4: Bound and applied MFN tariffs in selected countries (%), 2003–04

	Binding coverage	Bound tariff rate (all goods)	Applied tariff rate (manufactures)	Applied tariff rate (agriculture)	Overall applied tariff
Japan	99.6	5.0	3.3	10.4	4.7
Korea	94.4	16.1	6.6	42.5	11.9
China	100	10.0	9.5	15.0	10.3
Hong Kong	45.7	0.0	0.0	0.0	0.0
Malaysia	83.7	14.5	8.1	2.1	7.3
Thailand	74.7	25.7	14.6	16.2	14.7
Indonesia	96.6	37.1	6.1	8.0	6.4
Philippines	66.8	25.6	6.9	11.8	7.5
Vietnam	—	—	12.9	18.1	13.7
Taiwan	100.0	6.1	5.5	16.3	6.9
Singapore	69.2	6.9	0.0	0.0	0.0
India	73.8	49.8	25.3	30.0	28.3
Pakistan	44.3	52.4	16.1	13.9	15.9
Bangladesh	15.8	163.8	19.2	21.7	19.5
Sri Lanka	37.8	29.8	9.6	15.4	10.2
South Africa	96.5	19.1	5.3	9.1	5.8
Brazil	100.0	31.4	11.0	10.4	10.9
Chile	100.0	25.1	5.9	6.0	5.9
Mexico	100.0	34.9	14.7	26.4	15.9
Australia	97.0	9.9	4.6	1.1	4.2
New Zealand	99.9	10.3	3.4	1.7	3.2

Note: The figures are simple unweighted averages of the tariff rates.

Source: World Bank trade databases, http://siteresources.worldbank.org/INTRES/Resources/469232-1107449512766/tar2005a.xls

Table 5: Frequency of NTBs in developing countries (%), 1989–2000

Region	1989–94	1995–98	2000
East Asia and the Pacific	30.1	16.3	5.5
Latin America and the Caribbean	18.3	8.0	15.3
Middle East and North Africa	43.8	16.6	8.5
South Asia	57.0	58.3	13.3
Sub-saharan Africa	26.0	10.4	2.3

Note: Figures are regional averages of tariff lines subject to core NTBs, including all types of quantity restrictions and price administration or control, as well as monopolistic trading channels.

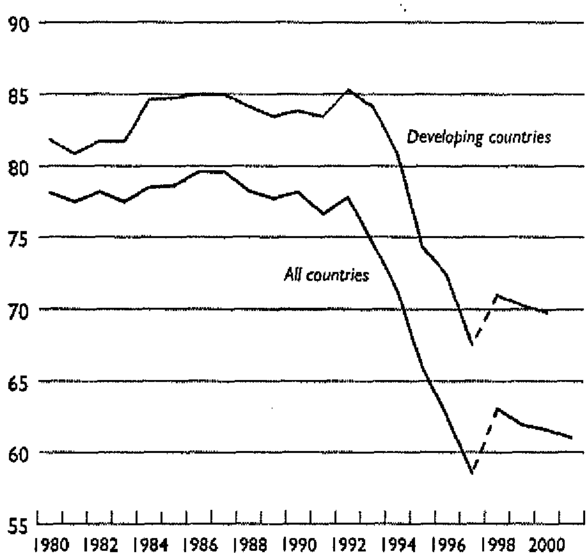
Source: For 1989–94 and 1995–98: IMF, http://www.imf.org/external/np/pp/eng/2005/021505.pdf, citing Hoekman B, 'Economic development and the WTO After Doha', World Bank Policy Research Working Paper No. 2851. Washington, DC: World Bank, June 2002; for 2000: Cordell Institute, http://www.cordellhullinstitute.org/TPA/Volume%207%20(2005)/Vol%207,%20No.%202%20-%20Thomas%20Dalsgaard%20on%20Trade%20Reform%20&%20Revenue%20Loss.pdf, citing World Bank, Global Monitoring Report 2004. Washington, DC: World Bank, 2004, Table 4.6.

Table 6: National regulatory changes regarding FDI by region, 1992–2005

		1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
World	More favourable	77	99	108	106	98	134	136	130	147	193	234	218	234	164
	Less favourable	—	1	2	6	16	16	9	9	3	14	12	24	36	41
Developed countries	More favourable	11	24	17	22	25	36	20	27	29	38	54	45	54	40
	Less favourable	—	—	1	2	3	6	4	5	—	3	2	3	6	4
Developing economies	More favourable	49	63	79	62	58	87	109	78	105	127	144	139	144	92
	Less favourable	—	1	1	3	10	5	3	2	2	10	9	20	27	30
Africa	More favourable	9	12	22	12	15	14	23	16	13	25	21	43	46	42
	Less favourable	—	—	—	—	2	1	4	2	2	—3	2	11	9	14
Latin America and the Caribbean	More favourable	9	17	14	18	14	30	13	17	29	18	15	16	26	7
	Less favourable	—	—	—	2	1	4	2	2	—	3	2	11	9	14
West Asia	More favourable	3	8	4	4	4	5	18	7	24	26	34	35	34	15
	Less favourable	—	—	—	—	—	—	—	—	1	2	1	4	1	1
South, East and South-East Asia	More favourable	27	26	39	28	25	33	52	37	38	58	74	44	37	28
	Less favourable	—	1	1	1	7	1	—	—	1	2	—	3	6	4
Oceania	More favourable	1	—	—	—	—	5	3	1	1	—	—	1	1	—

Source: Thomas Pollan, Economic Affairs Officer, UN Conference on Trade and Development capital account restrictions today, compared with 85% in the early 1990s (see Figure 7).

Figure 7: Countries with capital controls (% of total IMF membership), 1980–2000



Note: Based on a one (controlled) or zero (not controlled) classification (covering all capital account transactions). There was a definitional change from 1997 to 1998.

Source: IMF, The IMF's Approach to Capital Account Liberalization, IMF evolution report 2005, http://www.imf.org/external/np/ieo/2005/cal/eng/report.pdf

This liberalisation trend started in Japan, and then South Korea and Taiwan, in the 1950s, at a time when most developing countries were tightening regimes of import substitution and other forms of state intervention. The North-East Asian Tigers promoted exports through selective liberalisation, while retaining considerable import protection and restrictions on inward investment. Later, they gradually liberalised imports and FDI. Hong Kong returned to tariff-free trade and a fully open door to investment after the Second World War. Singapore followed, though after a brief flirtation with protection (when part of the Malaysian Federation). The other South-East Asian Tigers (Malaysia, Thailand, Indonesia and the Philippines) liberalised significantly, on both trade and FDI, from the 1970s. The countries of Indochina started gradual and halting market-

Table 7: Changes in average statutory tariff rates in China (%), 1992–2001

	All products		Primary products		Manufactures	
	Simple	Weighted	Simple	Weighted	Simple	Weighted
1992	42.9	40.6	36.2	22.3	44.9	46.5
1993	39.9	38.4	33.3	20.9	41.8	44.0
1994	36.3	35.5	32.1	19.6	37.6	40.6
1996	23.6	22.6	25.4	20.0	23.1	23.2
1997	17.6	18.2	17.9	20.0	17.5	17.8
1998	17.5	18.7	17.9	20.0	17.4	18.5
1999	17.2	14.2	21.8	21.8	16.8	13.4
2000	17.0	14.1	22.4	19.5	16.6	13.3
2001	16.6	12.0	21.6	17.7	16.2	13.0
Post-WTO accession	9.8	6.8	13.2	3.6	9.5	6.9

**Source: For 1992–98: World Bank, World Development Indicators. Washington, DC: World Bank, 1999, p.340; for tariff lines with imports from 1999 and China's final WTO offer: Ianchovichina E & W Martin, 'Economic impacts of China's accession to the World Trade Organisation', World Bank Policy Research Working Paper No. 3053. Washington, DC: World Bank, May 2003; CDS Consulting Co. provided applied tariffs for 2001; trade data comes from COMTRADE*

Table 8: China: Changes in the import coverage of NTBs (%), 1996 and 2001

	Licences and quotas	Licensing tendering	State only	Designated trading	Trading	Any NTB	No NTBs	Total
2001	12.8	2.7	0.5	9.5	6.2	21.6	78.4	100
1996	18.5	7.4	2.2	11.5	7.3	32.5	67.5	100

Source: Calculations for 2001 performed by Mei Zhen of MOFTEC during an internship at the World Bank; Ianchovichina E & W Martin, op. cit.

based reforms in the 1980s. Vietnam accelerated trade and investment liberalisation in the run-up to its WTO accession in late 2006.

China's historic opening dates back to 1978, but major trade and investment liberalisation took off from the early 1990s. Since then, China has swung from extreme protection to rather liberal trade policies – indeed, very liberal by developing-country standards. The protective impact of classic NTBs has come down to less than 5%; and the simple average tariff has come down from 42% in 1992 to under 10% after WTO accession – below the developing-country average (see Table 7, while Table 8 shows reductions in NTBs on imports).

The crowning point of China's reforms was its WTO accession in 2001. Its WTO commitments are by far the strongest of any developing country in the organisation. This holds for tariff ceilings on goods (including agriculture); NTBs for goods and services (with big-ticket sectors like financial services, telecoms, retail, transport and a host of professional services thrown open to foreign competition); all manner of strong domestic regulatory disciplines to improve transparency and promote competition; and administrative and judicial review procedures to ensure that WTO commitments are implemented domestically. (See Tables 7 and 9 for an indication of China's WTO commitments on tariffs and in services.)

In South Asia, Sri Lanka pioneered external liberalisation in the late 1970s. India's retreat from the 'licence raj' – its equivalent of Soviet-style central planning – began half-heartedly in the 1980s; but its decisive opening to the world economy dates back to 1991. The average tariff has come down to about 16% from 125% in 1991 (see Table 3). Most border NTBs, internal licensing restrictions and restrictions on manufacturing FDI have gone. This still leaves high protection in agriculture and services. Pakistan followed in the late 1990s.

In Latin America, Chile pioneered radical external liberalisation in the 1970s. Other Latin American countries followed in the 1980s (notably Mexico) and 1990s (notably Brazil, Argentina and Peru). African liberalisation was slow in the 1980s and faster in the 1990s. South Africa had a big opening of the economy in the run-up to and after the end of apartheid. The countries of East-Central Europe and the Baltic states had a 'big bang' transition from the plan to the market after 1989, which included massive liberalisation of trade and capital flows. This was less the case, and certainly more erratic, in Russia, other parts of the former Soviet Union and South-Eastern Europe. However, liberalisation has recently accelerated in some of these countries, e.g. Romania, Bulgaria, Georgia and parts of the former Yugoslavia.

Finally, trade-and-investment liberalisation in the old OECD countries has taken place in small steps since the 1980s – which is not surprising, since these are largely open economies in which the bulk of liberalisation was done in the 1950s and 1960s. The exceptions are Australia and New Zealand. After over a century of protection, both opened decisively to the world economy in the 1980s.

Table 9: Coverage of specific commitments (%)

	High-income countries	Low- and middle-income countries	Large developing nations	China
Market access				
Unweighted averahe count (sectors-modes listed as a share of maximum possible)	47.3	16.2	38.6	57.4
Average coverage (sectors-modes listed as a share of maximum possible, weighted by openness or binding factors)	35.9	10.3	22.9	38.1
Coverage/count (average coverage as a share of the average count)	75.9	63.6	59.3	66.4
No restrictions as a share of total offer (unweighted count)	57.3	45.5	38.7	40.2
No restrictions as a share of maximum possible	27.1	7.3	14.9	23.1
National treatment				
Unweighted average count (sectors-modes listed as a share of maximum possible)	47.3	16.2	38.8	57.4
Average coverage (sectors-modes listed as a share of maximum possible, weighted by openness or binding factors)	37.2	11.2	25.5	45.0
Coverage/count (average coverage as a share of the average count)	78.6	69.1	66.1	78.4
No restrictions as a share of total offer (unweighted count)	65.1	58.0	52.3	63.5
No restrictions as a share of maximum possible	30.8	9.4	20.2	36.5
Memo item				
No restrictions on market access and national treatment as a share of maximum possible	24.8	6.9	14.3	29.8
Number of sectors committed	293.0	100.0	239.0	356.0

Source: Mattoo, "China's accession to the WTO", op cit., p.303. The breadth and depth of commitments by other countries are understated because their more recent commitments in telecommunications and financial services have not been taken fully into account.

Note: The breadth and depth of commitments by other countries are understated, because their more recent commitments in telecommunications and financial services have not been taken fully into account.

Source: Mattoo A, 'China's accession to the WTO: The services dimension', Journal of International Economic Law, 6, 2, p.303, http://jiel.oxfordjournals.org/cgi/reprint/6/2/299

3. THE POLITICAL ECONOMY OF TRADE POLICY REFORM

The politics of economic policy reform is as much about distribution as it is about wealth generation. This is true of international politics; it is even truer of domestic politics. Shifts in trade policy – from protection to openness or vice versa – trigger redistribution of gains and losses between/among regions (especially between rural and urban areas), sectors of the economy (agriculture, industry, services), classes (owners of capital, educated and skilled workers, semi- and unskilled workers), and even between/among ethnic groups. Such disruption, especially in the short term, can be particularly unsettling in developing countries with political instability, corrupt elites, wide disparities in wealth and influence, meagre safety nets, ethnic divides and generally brittle institutions. Hence, trade and other forms of liberalisation take place in a snake pit of messy and sometimes poisonous politics.

What are the determinants of trade policy reform, especially in the direction of liberalisation? What follows is a simple taxonomy of relevant factors: a) circumstances, especially crises; b) interests; c) ideas; d) institutions; and e) factor endowments.

a) Circumstances/crises

Events, dear boy, events. Harold Macmillan

When a man knows he is going to be hanged in a fortnight, it concentrates the mind wonderfully. Dr Johnson

The practical politician, official or businessperson knows that choices are dictated by responses to often-unanticipated events. In reality, major episodes of economic policy reform have mostly taken place in response to political and/or economic crises.[14] A macroeconomic crisis, with symptoms such as extreme internal or external indebtedness, hyperinflation, a terms-of-trade shock, or a severe payments imbalance leading to a plummeting currency, provides

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[14] Haggard S & J Williamson, 'The political conditions for economic reform', in Williamson J, *op. cit.*, pp.527–96.

the classic backdrop. This is when 'normal politics' is suspended, and when a period of 'extraordinary politics' can provide a window of opportunity for thoroughgoing reforms (which would not be possible in 'normal' political circumstances).[15] Examples are legion: Chile in 1973–74; Mexico in 1986; Brazil and Argentina in the early 1990s; South Africa in the mid-1990s; Sri Lanka in 1977; India in 1991; Eastern Europe and the former Soviet Union in the early 1990s; Australia and New Zealand in 1983–84.

But the crisis explanation cannot be taken too far. Firstly, a crisis can precipitate swings both ways: sometimes towards liberalisation; sometimes the other way, as happened during the Great Depression in the 1930s, and, to a lesser extent, in the 1970s after the first oil-price shock. Secondly, different governments act in different ways in response to similar external shocks. Thirdly, a crisis might trigger some reforms, but it is no guarantee of the sustainability of those reforms, nor of further reforms down the line. That is one key difference between East-Central Europe and the Baltic states, on the one hand, and Russia and other parts of the former Soviet Union, on the other. Lastly, there are counter-examples of gradual, but cumulatively substantial reforms without a sudden crisis as a triggering mechanism. That is, roughly, the East Asian record.

Why have some countries sustained reforms, while others have not? Why have some gone farther than others? What happens to a reform programme post-crisis, when 'normal' political and economic conditions return? These questions demand supplementary explanations.

b) Interests

A good cause seldom triumphs without someone's interest behind it.

John Stuart Mill

Mainstream economists, following Adam Smith, tend to rely on an interest group explanation of trade politics. Free trade is the optimal policy in most circumstances (they say), but protection is more often the result, because organised

[15] Balcerowicz L, *Socialism, Capitalism, Transformation*. Budapest: Central European University Press, 1995.

rent-seeking interests demand protection, and politicians and officials supply it. The benefits of free trade are diffused over the broad majority of consumers, but its costs bear down disproportionately on minority producer interests. The latter, not the former, have the incentive to organise for collective action.[16] In reality, 'iron quadrangles' of politicians, bureaucrats, employers and unions imposed a straitjacket of protection in developing countries from the 1930s to the 1970s. Mostly this benefitted capital-intensive, unionised, urban manufacturing industries producing for the domestic market, at the expense of agriculture and tradable sectors. India's licence raj was its most notorious incarnation. In many countries, a crisis was used to overcome interest group opposition and push through liberalising reforms (as happened in India in 1991).

But what role do interest groups play after an initial burst of external liberalisation, and in post-crisis conditions when 'normal' politics returns? Here the picture differs across countries and regions. In some parts of the world, protectionist coalitions have halted or slowed down liberalisation. This is the case with nomenklatura coalitions in Russia, Ukraine and other parts of the former Soviet Union. Elsewhere, radical opening has triggered major economic shifts in favour of sectors exposed to the world economy. Traditional protectionist interests have been weakened, and countervailing coalitions have emerged. The latter comprise exporters, users of imported inputs, multinationals with global production networks, and cities and regions seeking to be magnets for trade and FDI. These interests lobby for the maintenance and extension of open trade and FDI regimes.[17] This has happened in strong liberalising countries in East Asia, Eastern Europe and Latin America. It happened in Australia and New Zealand from the early 1980s. It is also evident in India after the 1991 reforms.

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16 Olson M, *The Rise and Decline of Nations: Economic Growth, Stagflation and Social Rigidities*. New Haven: Yale University Press, 1982; Krueger A, 'The political economy of the rent-seeking society', *American Economic Review*, 64, 1974, pp.291–303.

17 Ricardo-Viner and Hecksher-Ohlin models of comparative advantage are used to explain interest group activity for and against free trade in different countries with different factor endowments. See Rogowski R, *Commerce and Coalitions: How Trade Affects Domestic Political Alignments*. Princeton: Princeton University Press, 1990.

c) Ideas

It is the word in season that does much to decide the result. John Stuart Mill

Madmen who hear voices in the air are distilling their frenzy from the academic scribblings of some defunct economist or political philosopher. Indeed the world is ruled by little else. John Maynard Keynes

It is always difficult to gauge the influence of ideas (or ideology) in policy.[18] But practical observation teaches us that the prevailing climate of ideas, interacting with interests and events, can entrench or sway this or that set of policies. A policy consensus on import substitution, state planning and foreign aid was strongly embedded in developing-country governments and international organisations up to the 1970s. This was buttressed by a post-colonial political ideology of mercantilist state building, and an interventionist consensus in development.[19] This set of ideas was overturned by what came to be called the Washington Consensus, which reflected sea changes in political ideology and development economics. The latter returned to classical and neo-classical foundations, emphasising market-based pricing, 'outward orientation' and the prevalence of 'government failure' over 'market failure', not to mention a dose of aid scepticism.

Washington Consensus ideas took stronger hold in countries where reforms were substantial, especially in ministries of finance, central banks and presidential/prime-ministerial offices. These agencies tend to be the cockpits of policy reform. But now the climate of ideas has changed somewhat. This does not presage a return to full-blown pre-Washington Consensus thinking. The pendulum, however, is swinging towards more attention to market failure and government intervention, e.g. to ease back on further liberalisation, expand 'policy space' and promote infant industries, defend 'food security' and increase foreign aid. The question is what effect this is having, and is likely to have, on trade policies.

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18 On ideational approaches, see Goldstein J, *Ideas, Interests and American Trade Policy*. Ithaca: Cornell University Press, 1994.

19 Bauer PT, *From Subsistence to Exchange and Other Essays*. Princeton: Princeton University Press, 2000a; Lal D & H Myint, *op. cit.*

d) Institutions

In the broad sense, institutions are the steel frame of the economy, its 'formal rules and informal constraints', according to Douglas North. The legal framework governing property rights and contracts, production and consumption, comes to mind. 'Formal rules' comprise bankruptcy laws, competition laws, regulations governing financial markets and corporate governance, and much else besides. 'Informal constraints' are (often non-legal) traditions and norms influencing the intersecting worlds of business, government and the law.

Evidently, 'institutions' are much broader and more difficult to pin down than 'policies'; and the two are, of course, intimately connected. Historically conditioned institutions, domestic and external, set the scene for government action, interest group lobbying and the influence of ideas. They are the arena for policy choices and their implementation. Making generalisations about institutional constraints on policy choice, and how this might explain differences in national and regional economic performance over time, is notoriously difficult. To what extent must 'good' institutions be in place before 'good' policies can take hold and work their magic? Conversely, to what extent are institutions the result, rather than the cause, of policy choices? These are chicken-and-egg questions.

In the narrow sense, institutions are the organisational map of decision making at the junction where politics and public policy meet business and society. On trade policy, this map is much more complicated than it used to be. Trade policy, as we know, is no longer just about a clutch of border instruments, and the preserve of trade ministries. It is increasingly 'trade-related', a matter of non-border regulation reaching deep into the domestic economy and its institutions. That is reflected in more complex multilateral, regional and bilateral trade agreements. This brings in agencies across the range of government, and many actors outside government as well.

Nowadays the management of trade policy involves the division of labour among the executive, legislature and judiciary; the role of the lead ministry; the participation of other ministries and regulatory agencies on trade and trade-related policies; the WTO mission in Geneva; inter-agency coordination within government; the involvement of non-governmental actors, such as business and unions, and now including NGOs and think tanks; and the role of donors and international organisations.

Inasmuch as one can make generalisations about institutions and trade policy in developing countries, here are a couple. Firstly, it is the more advanced developing countries (in terms of per capita income and human development indicators) that have liberalised more and plugged themselves better into globalisation than other developing countries. They have lower trade and FDI barriers, higher ratios of trade and FDI to GDP, and better-performing tradable sectors of their economies.

They also have stronger institutions in the broad sense: better enforcement of property rights and contracts (i.e. the rule of law), better-functioning judiciaries and public administration, better-regulated financial markets, a stronger competition culture, less corruption and so on.[20] This is the divide that separates Chile and a few other Latin American countries, Eastern Europe, the North-East Asian and South-East Asian Tigers, and a tiny handful of African countries (Mauritius, Botswana and South Africa) from the rest.

There are, however, two gigantic anomalies: China and India. Both are still low-income countries with weak institutions (going by some of the indicators mentioned above). Institutional improvements have taken place, but these have lagged well behind big policy shifts – not least lower trade and FDI restrictions – and fast-paced global integration. The World Bank's governance and business climate indicators, for example, point to large institutional and policy differences among developing countries. That is predictable enough. But they also point to relatively weak institutions, as well as the high 'red tape' costs of doing business, in China and India (see Tables 10, 11 and 12).

Secondly, looking at institutions in the narrower organisational sense, strong and sustained trade policy and wider economic policy reforms were driven, more often than not, by powerful presidential or prime-ministerial offices, ministries of finance and central banks, insulated from blocking pressures in other parts of government and outside government. This was more pronounced in advanced developing countries than elsewhere. These countries also have stronger capacity, in terms of qualified, experienced personnel and other resources, for formulating and implementing trade policy, whether done unilaterally or through international negotiations and agreements. Again, China and India are exceptional:

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20 World Bank, *Globalisation, Growth and Poverty: Building an Inclusive World Economy*. Washington, DC: World Bank, 2002a; Michalopoulos C, *op. cit.*

Table 10: World ranking in ease of doing business for selected countries, 2006

	Ease of doing business	Starting a business	Dealing with licenses	Employing workers	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Closing a business
Singapore	1	11	8	3	12	7	2	8	4	23	2
New Zealand	2	3	18	10	1	3	1	10	12	15	21
Hong Kong	5	5	64	16	60	2	3	5	1	10	14
Australia	8	2	29	9	27	3	46	35	23	7	12
Japan	11	18	2	36	39	13	12	98	19	5	1
Thailand	18	28	3	46	18	33	33	57	103	44	38
Korea	23	116	28	110	67	21	60	48	28	17	11
Malaysia	25	71	137	38	66	3	4	49	46	81	51
South Africa	29	57	45	87	69	33	9	74	67	43	65
Taiwan	47	94	148	154	24	48	60	78	42	62	4
Pakistan	74	54	89	126	68	65	19	140	98	163	46
Bangladesh	88	68	67	75	167	48	15	72	134	174	93
Sri Lanka	89	44	71	98	125	101	60	157	99	90	59
China	93	128	153	78	21	101	83	168	38	63	75
Vietnam	104	97	25	104	34	83	170	120	75	94	116
Brazil	121	115	139	99	124	83	60	151	53	120	135
Philippines	126	108	113	118	98	101	151	106	63	59	147
India	134	88	155	112	110	65	33	158	139	173	133
Indonesia	135	161	131	140	120	83	60	133	60	145	136

Note: The numbers correspond to each country's aggregate ranking on the ease of doing business and on each of the ten topics that comprise the overall ranking.

Source: World Bank Doing Business database, http://www.doingbusiness.org/

Table 11: Indicators for trading across borders for selected countries, 2006

	Ease of trading across borders (world ranking)	Documents for export (number)	Time for export (days)	Cost to export ($ per container)	Documents for import (number)	Time for import (days)	Cost to import ($ per container)
Hong Kong	1	2	5	425	2	5	425
Singapore	4	5	6	382	6	3	333
New Zealand	12	5	8	355	9	13	555
Japan	19	5	11	789	7	11	847
Australia	23	6	9	795	5	12	945
Korea	28	5	12	780	8	12	1,04
China	38	6	18	335	12	22	375
Taiwan	42	8	14	747	8	14	747
Malaysia	46	6	20	481	12	22	428
Brazil	53	7	18	895	6	24	1,145
Indonesia	60	7	25	546	10	30	675
Philippines	63	6	18	1,336	7	20	1,336
South Africa	67	5	31	850	9	34	850
Vietnam	75	6	35	701	9	36	887
Pakistan	98	8	24	996	12	19	1,005
Sri Lanka	99	8	25	797	13	27	789
Thailand	103	9	24	848	12	22	1,042
Bangladesh	134	7	35	902	16	57	1,287
India	139	10	27	864	15	41	1,244

Note: The costs and procedures involved in importing and exporting a standardised shipment of goods are detailed under this topic. Every official procedure involved is recorded, starting with the final contractual agreement between the two parties and ending with the delivery of the goods.
Source: World Bank Doing Business database, http://www.doingbusiness.org/

they are low-income countries with relatively weak institutions (in the broad sense), but with relatively strong trade policy capacity.

e) Factor endowments

Explaining the trajectory of policy reforms is not complete without factoring in the relative mix of land (or natural resources), labour and capital in an econ-

Table 12: Percentile world rank of governance indicators for selected countries, 2005

	Voice and accountability	Political stability/ no violence	Government effectiveness	Regulatory quality	Rule of law	Control of corruption
Singapore	38.2	84.0	99.5	99.5	95.7	99.0
Hong Kong	52.2	89.6	92.8	100.0	91.3	92.1
Japan	74.9	80.2	84.7	85.6	89.4	85.2
Malaysia	34.3	62.3	80.4	66.8	66.2	64.5
Taiwan	69.1	64.2	83.7	79.7	78.7	70.9
Korea	68.1	60.8	78.9	71.8	72.5	69.0
India	55.6	22.2	51.7	41.1	56.0	46.8
Thailand	49.3	29.2	66.0	63.9	56.5	51.2
China	6.3	75.9	52.2	44.6	40.6	30.5
Vietnam	7.7	59.0	45.0	25.7	42.0	26.6
Indonesia	40.6	9.0	37.3	36.6	20.3	21.2
South Africa	70.5	41.5	75.6	67.3	57.0	69.5
Brazil	57.0	40.6	55.0	55.0	43.0	48.3
Australia	94.7	73.6	94.7	96.0	94.7	95.1
New Zealand	96.6	91.5	95.2	97.0	97.1	98.5
Sri Lanka	39.6	10.8	40.7	50.0	54.1	47.3
Philippines	47.8	17.5	55.5	52.0	38.6	37.4
Bangladesh	31.4	6.6	21.1	14.9	19.8	7.9
Pakistan	12.6	5.7	34.0	27.7	24.2	15.8

Note: Percentile rank indicates the percentage of countries worldwide that rate below the country (subject to margin of error). Higher values indicate better governance ratings. Percentile ranks have been adjusted to account for changes over time in the set of countries covered by the governance indicators.

Source: World Bank governance indicators, http://web.worldbank.org/WBSITE/EXTERNAL/WBI/EXTWBIGOVANTCOR/0,,contentMDK: 20771165~menuPK:1866365~pagePK:64168445~piPK:64168309~theSitePK:1740530,00.html

omy.[21] We know from recent economic history that the star developing-country performers are from East Asia. These countries had different starting positions, but, at a certain stage of development, relative labour abundance allowed them to break into labour-intensive manufactured exports, which became an engine of growth and in turn aided poverty reduction and human-welfare improvement. Of course this was not inevitable: it depended on the right policies and

21 Lal D & H Myint, *op. cit.*

improving institutions. South Asia, with similar factor endowments, remained stuck on a low-growth, high-poverty path because it did not adopt market-based policies. Latin American and African countries, on the other hand, are largely land- or resource-abundant and labour-scarce. By dropping import substitution policies, they are better able to exploit comparative advantage in land and resources – as Brazil, Argentina, Chile, Australia and New Zealand have done in agriculture since they liberalised, and as all the latter and many other countries besides are doing in the present China-driven commodities boom. Thus a simple story based on early 21st-century comparative advantage would point to all-round gains from trade: for technologically advanced and capital-abundant countries in the West; the labour-abundant countries of East and South Asia; and land- and resource-abundant countries elsewhere.

But the political economy of factor endowments reveals a different and more problematic story. Arguably, land- and resource-abundant countries are at a structural disadvantage compared with labour-abundant countries. By plugging into global markets for manufacturing, and now labour-intensive services too, the latter seem to be on sustainable growth paths. Labour-intensive exports attract FDI (and the technology and skills that come with it), and feed quickly into poverty-reducing, welfare-improving employment, and, more gradually, into better infrastructure and institutions. This creates and strengthens a constellation of interests to support open trade and FDI policies.

On the other hand, land- and resource-abundant countries, given their relatively high price of labour, seem to be crowded out of global manufacturing markets by East Asian (especially Chinese) competition.[22] This leaves them dependent on cyclical and volatile commodities markets. FDI in resource-abundant countries tends to be capital-intensive and generate big rents in not-so-competitive market segments. Often the result is an FDI enclave, without an employment, technology or wealth spillover to the rest of the economy, but with big profits to distribute among a corrupt local business and political elite. Most countries dependent on resources have the interest group constellation to squander rents from resource booms, but not to spread wealth and improve governance and institutions. A retreat to protectionism, however, would repeat past mistakes and make matters worse. This is the dilemma inherent in the 'China-in-Africa' phenomenon. But

22 Wolf M, *op. cit.*, pp.146–49.

there are notable exceptions to the 'resource curse' rule: Chile has successfully exploited comparative advantage in agriculture and resources (mainly copper) through liberal trade policies, while diversifying the economic base and improving institutions. That is also true of Australia and New Zealand.

f) Preliminary summary

In most strongly liberalising countries, a political or macroeconomic crisis has led to a big opening of the economy; new open-economy interest group constellations have emerged to counter traditional protectionist interests; open-market ideas have become entrenched; and stronger institutions are better able to support and manage open-market policies. Some countries, e.g. China and others in East Asia, have gone down this path without the catalyst of a macroeconomic crisis. Generally, advanced developing countries have more liberal trade policies and stronger institutions, and are more globally integrated than the rest. China and India are the two big exceptions: they have liberalised extensively and integrated quickly into the global economy, but with still-weak institutions. Labour-abundant countries in East Asia, and now in South Asia, best fit the big picture of external liberalisation and global integration. The picture looks different in countries that have liberalised and globalised less. Resource-abundant countries in Latin America, Africa, the Middle East, Russia and other parts of the former Soviet Union are now doing well in the China-driven commodities boom, but their political economy is problematic: their predatory governments and interest groups are geared more to squandering rents than to creating and spreading wealth sustainably.

4. MULTI-TRACK TRADE POLICY

Another way of cutting into trade policy reform is to look at it on several tracks. Some reforms are carried out unilaterally, others reciprocally through (bilateral, regional, multilateral) trade negotiations, or in agreements with donors. Most developing countries now operate trade policy on all these tracks concurrently, though the relative balance differs from country to country.

a) Unilateral liberalisation

I trust the government . . . will not resume the policy which they and we have found most inconvenient, namely the haggling with foreign countries about reciprocal concessions, instead of taking that independent course which we believe to be conducive to our own interests. ... let us trust that our example, with the proof of practical benefits we derive from it, will at no remote period insure the adoption of the principles on which we have acted.

Sir Robert Peel, announcing the repeal of the Corn Laws, 1846

Liberalise first, negotiate later. Mart Laar, former prime minister of Estonia

Compelling political and economic arguments favour unilateral liberalisation, with governments freeing up international trade and flows of capital and labour independently, not in the first instance via international negotiations. As any student of trade economics knows, welfare gains result directly from import liberalisation, which replaces comparatively costly domestic production and reallocates resources more efficiently, and spurs capital accumulation, economies of scale and longer-run dynamic gains such as the transfer of technology and skills.[23] Similar and related arguments apply to the liberalisation of inward investment and the cross-border movement of people.

Such gains come quicker through a country's own, unconditional liberalisation than through protracted, politicised and bureaucratically cumbersome international negotiations. This Nike strategy ('Just Do It!') can make political sense too. Rather than relying on one-size-fits-all international blueprints, governments have the flexibility to initiate policies and emulate better practice abroad in experimental, trial-and-error fashion, tailored to specific local

[23] There is the theoretical possibility of (usually large) countries being able to exercise long-run market power in international demand for certain goods. This enables them to shift the terms of trade in their favour by means of an 'optimal tariff'. The corollary is that these countries should only lower tariffs if others reciprocate, in order to avoid worsening terms of trade. In reality, very few countries have such long- run market power. And retaliatory tariffs by other countries could nullify terms-of-trade gains. Thus – not for the first time – a neat theory turns out to have limited practical relevance; see Irwin D, *Against the Tide: An Intellectual History of Free Trade*. Princeton: Princeton University Press, 1996, pp.106–15.

conditions. In David Landes's words, it is 'initiated from below and diffused by example'. This was the preferred method of the classical economists from Smith to Marshall, and of the titans of mid-Victorian British politics.[24]

In 20th and 21st-century conditions of democratic politics and vigorous interest group lobbying, unilateral liberalisation is, of course, a much more difficult proposition than it was in the 19th century. But observers often forget that the recent trade policy revolution outside the West has come more 'from below' than 'from above'. The World Bank estimates that, between 1983 and 2003, about 65% of developing-country tariff liberalisation (a 21% cut in average weighted tariffs) has come about unilaterally, with 25% coming from the Uruguay Round agreements and only 10% from preferential trade agreements (PTAs) (see Figure 8).

True, many governments liberalised reluctantly as part of IMF and World Bank structural adjustment programmes. But the strongest liberalisers have been unilateral liberalisers, going ahead under their own steam without the need for much external pressure. Prominent among them are the East Asian countries, now led by China, as well as Chile, Mexico, the East European countries, Australia, New Zealand and South Africa. Nearly all of India's post-1991 liberalisation has been done unilaterally.

Unilateral liberalisation has been particularly strong in East Asia (see Figures 9 and 10 for unilateral tariff-cutting in selected countries).

The bulk of trade and investment liberalisation by the first- and second-generation Tigers of North-East and South-East Asia was done unilaterally. China's massive trade and investment liberalisation was mostly done unilaterally, before WTO accession. Its extremely strong WTO commitments and its generally constructive participation in the WTO since accession are more the consequence than the cause of its sweeping unilateral reforms. China is in some ways today what Britain was in the second half of the 19th century: the unilateral engine of freer trade. It could well spur a pick-up in trade and FDI liberalisation elsewhere, especially in Asia. Recently, India has accelerated its liberalisation of tariffs and FDI – outside trade negotiations. Would this have happened, or happened as fast if China had not concentrated minds? Probably not.

That is not to say that China-induced unilateral liberalisation is a total solution. It is unlikely to induce further external liberalisation in the developed

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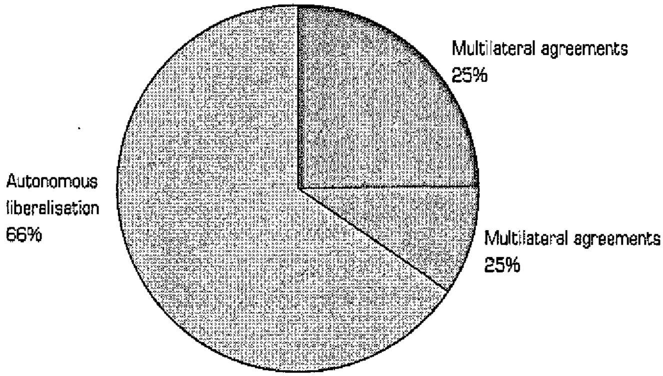
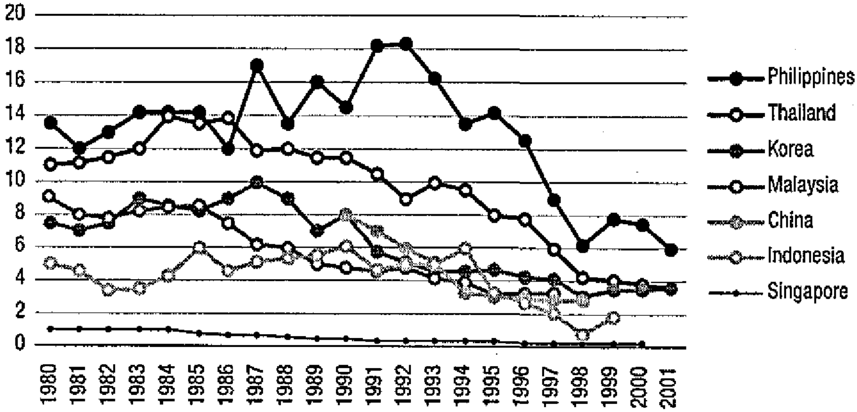
[24] Sally R, 1998, *op. cit.*

Figure 8: Share of total tariff reduction, by type of liberalisation, 1983-2003



Source: World Bank, http://siteresources.worldbank.org/INTGEP2005/Resources/GEP107053_Ch02.pdf

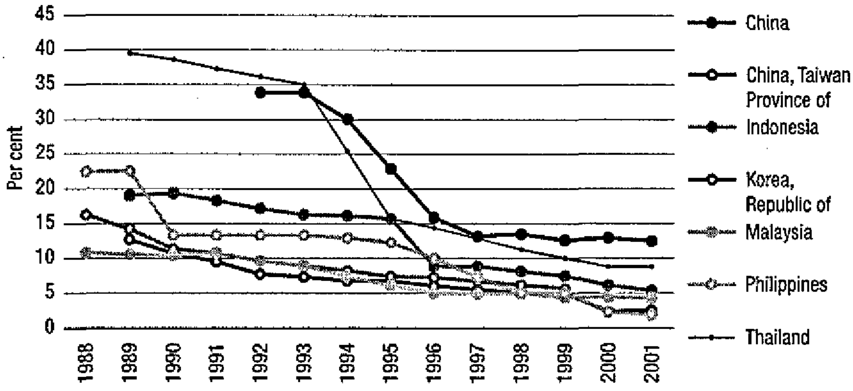
Figure 9: Unilateral tariff cutting* in East Asia, 1980-2001



** The diagram shows tariff revenue as a share of import value over time.*

Source: Ando & Kimura (2005) cited in Baldwin R, 'Managing the noodle bowl: The fragility of East Asian regionalism', 2006, http://www.sussex.ac.uk/Units/caris/CARIS/T.Carpenter-R.Baldwin-Sussex%20RTA%20Conference-Manage_CEPR_DP.pdf

Figure 10: Formal unilateralism: Reductions in applied MFN tariffs on machinery and transport equipment in East Asia, 1988–2001



Source: Kimura, Takahashi, and Hayakawa (2005), cited in Baldwin R, op. cit.

world, and least of all in the US, EU and Japan. In the developing world, its results will inevitably be patchy and messy. On its own, it cannot slay protectionist dragons and solve international commercial conflicts – least of all in agricultural trade, where unilateral liberalisation has been much more limited than in industrial goods and services. More importantly, perhaps, it does not provide binding and enforceable rules for stable and open international commerce. That leaves room for reciprocal negotiations and international agreements, i.e. for the WTO and PTAs.

b) Multilateral liberalisation

The great political virtue of multilateralism, far exceeding in importance its economic virtues, is that it makes it economically possible for most countries, even if small, poor and weak, to live in freedom and with chances of prosperity without having to come to special terms with some Great Power. Jacob Viner

In recent years, the impression has often been given of a vehicle with a proliferation of backseat drivers, each seeking a different destination, with no map and no intention of asking the way.

Sutherland Report

Given the realities of modern politics – interest group lobbying for protection, ingrained mercantilist thinking, the perception that liberalisation hurts the poor and vulnerable – unilateral liberalisation is often difficult to achieve in practice. The rationale of 'multilateralised reciprocity' is that General Agreement on Tariffs and Trade (GATT)/WTO negotiations help to contain protectionist interests and mobilise exporting interests; and multilateral agreements provide fair, non-discriminatory rules for all. Perhaps the greatest utility of the WTO is that it provides a framework of rules to assist (mainly developing-country) governments that have strategically chosen to take their national economies in a market-oriented, globally integrated direction. The accessions of China and Vietnam are textbook examples of how the WTO should work.

That said, the standard raison d'être for multilateral rules-based trade liberalisation was easier said in the old GATT than done in the WTO. In many ways, the WTO is the victim of its own success: of the successful conclusion of the Uruguay Round and the huge transition from the GATT to the WTO.[25]

Multilateral liberalisation was successful during the GATT when the latter had a relatively slim agenda, club-like decision making dominated by a handful of developed countries (especially the US and EU), and the glue of Cold War alliance politics. It has proved spectacularly unsuccessful in the WTO. Now, the WTO agenda, especially on non-border regulation, is technically more complicated, less amenable to the reciprocal exchange of concessions, administratively more burdensome and politically much more controversial; decision making is a chaotic mess in a general assembly with near-universal membership; and the unifying glue of the Cold War has dissolved. The failure of the Doha Round (as of the time of writing) probably shows that future multilateral liberalisation will be elusive, and modest at best.

Arguably, the best the WTO can hope for post-Doha Round is to lock in pre-existing unilateral liberalisation through binding commitments, and gradually improve the functioning of non-discriminatory multilateral rules. That implies scaling back ambitions and expectations. Market-access and rule-making negotiations should be more modest and incremental, and maybe trade rounds should become a thing of the past. Perhaps there should be more emphasis

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25 The following argument draws on Sally R, 'Trade policy 2006: A *tour d'horizon*', *World Economics* 7, 1, January–March 2006b, pp.49–71.

on the WTO as an OECD-type forum to share information and ideas and to improve transparency through mutual policy surveillance, especially for developing countries. More attention should also be given to the technical, everyday task of administering trade rules.

Even achieving these objectives will be a tall order, given the present parlous state of the WTO. There is every prospect that multilateral trade rules will be undermined by major players seeking to evade them, and as a result of proliferating and discriminatory bilateral trade agreements. Weaker multilateral rules will be a much larger cost for developing countries than the extra multilateral liberalisation forgone as a result of Doha Round failure.

c) Bilateral and regional liberalisation

We will work with can do, not won't do, countries. Robert Zoellick

By July 2005, 330 PTAs had been notified to the GATT/WTO – 206 of them since the establishment of the WTO in 1995. Over 180 are currently in force, with many more expected to be operational soon (see Figure 11).

Of the PTAs in force, 84% are free trade agreements (FTAs), with customs unions and partial-scope agreements making up the rest. Bilateral (country-to-country) agreements account for over 75% of PTAs in force and almost 90% of those under negotiation. PTA activity has increased pace since 1999–2000, and even more so since the launch of the Doha Round.[26] (Figures 12, 13 and 14 show PTA/FTA patterns in East Asia, Africa and the Americas.)

Eastern Europe, Africa and Latin America have long been involved in PTA activity. East Asia, which previously relied on non-discriminatory unilateral and multilateral liberalisation, is now playing PTA catch-up, as is South Asia. All the major regional powers – China, India and Japan – are involved in Asian PTAs, as are the US, the EU, Korea, Australia, New Zealand, Hong Kong, other South Asian countries and the ASEAN countries.

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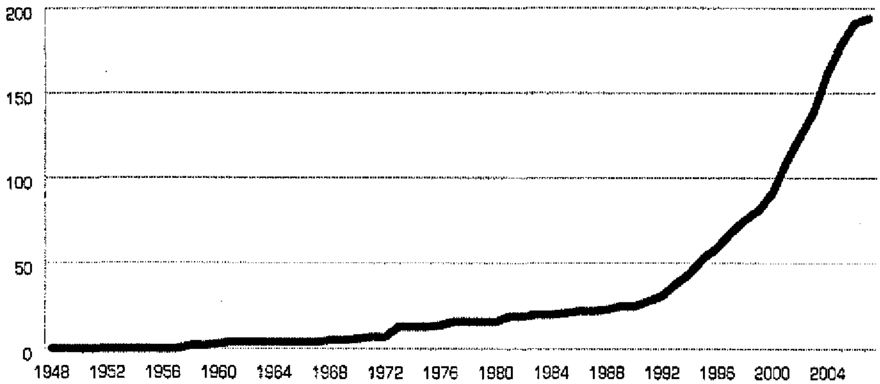
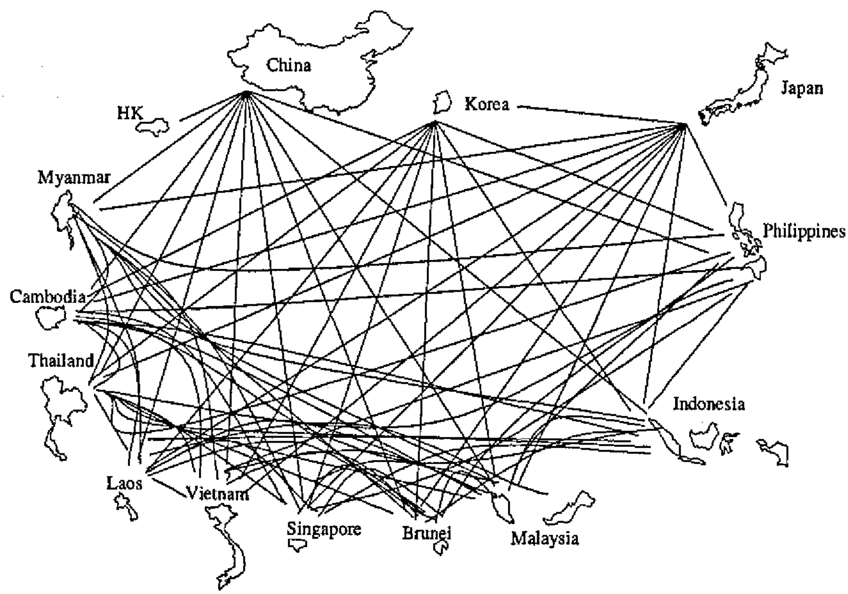
[26] WTO (World Trade Organisation), *Regional Trade Agreements: Facts and Figures*, 2006, http://www.wto.org/english/tratop_e/region_e/regfac_e.htm; Crawford J-A & R Fiorentino, 'The changing landscape of regional trade agreements', *WTO Discussion Paper* No. 8, 2005, http://www.wto.org.

Figure 11: PTAs by date of entry into force, 1948–2004



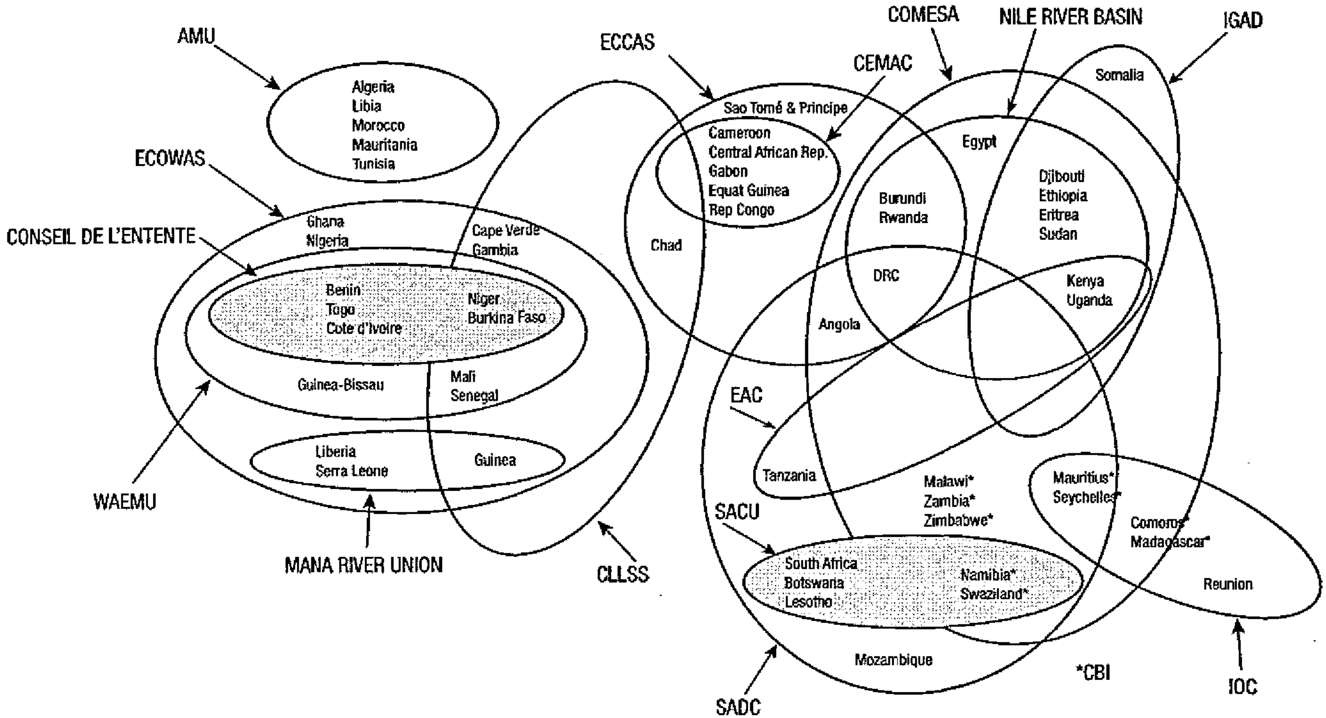
Source: WTO, http://www.wto.org/english/tratop_e/region_e/summary_e.xls

Figure 12: PTA/FTA patterns in East Asia: The noodle bowl syndrome, 2006



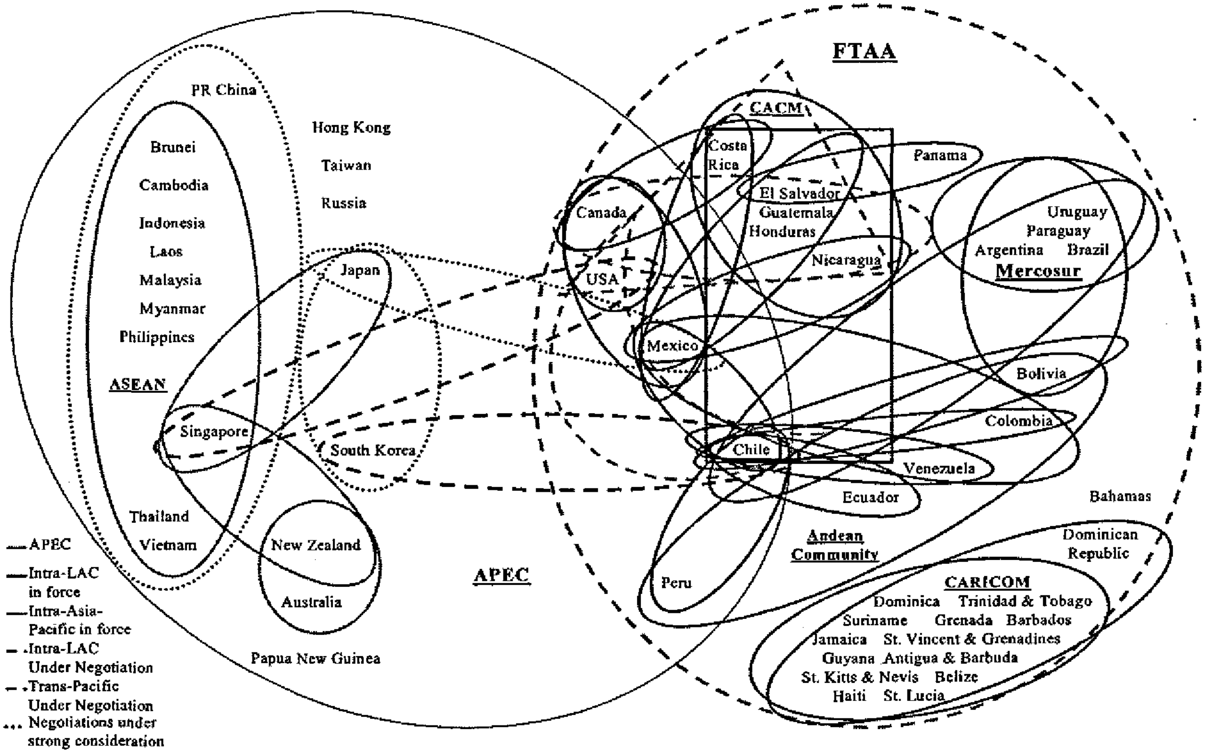
Note: The map shows PTAs/FTAs signed or under negotiation in January 2006. East Asia is defined here as the ten ASEAN countries, China, Japan and Korea.
Source: Baldwin R, op. cit.

Figure 13: PTA/FTA patterns: The noodle bowl syndrome in Africa



Source: World Bank, 'Trade note', 13 September 2005, http://siteresources.worldbank.org/INTRANETTRADE/Resources/239054-1126812419270/TradeNote24_Newfarmer.pdf

Figure 14: PTA/FTA patterns: The noodle bowl syndrome in the Americas



Source: Devlin R & A Estevadeordal, 'Trade and cooperation: A regional public goods approach', http://www.pecc.org/trade/papers/vancouver-2002/estevadeordal.pdf

Why this rush of PTA activity? Proponents argue that small clubs of like-minded members can take liberalisation and rules faster, wider and deeper than in the WTO, and act as 'building blocks' to further multilateral liberalisation and rule making. Sceptics say they are 'stumbling blocks', diverting attention from the WTO, creating 'spaghetti bowls' of discriminatory trade restrictions, and generally favouring powerful players at the expense of the weak.[27]

The reality is mixed. Unilateral and multilateral liberalisation blunt the damaging effects of PTAs. There is little prospect of the world economy retreating to the warring trade blocs of the 1930s. Strong, 'WTO-plus' PTAs, i.e. with comprehensive sectoral coverage, more ambitious market-access and rules commitments than in the WTO, and simple, harmonised rules of origin, can also make sense. But these are rare. The EU, the North American Free Trade Area and the Australia–New Zealand Closer Economic Relationship are relatively strong PTAs. The record in developing-country regions, however, is not encouraging. South–South PTAs and most North–South PTAs tend to be driven by vague, muddled and trivial foreign-policy objectives with little relevance to commercial realities. Latin America and Africa have a messy patchwork of weak FTAs that do not liberalise much trade or improve upon WTO rules, but do create complications, especially through trade-restricting rules of origin, and divert attention both from the WTO and from unilateral reforms. This is also the emerging picture of FTAs in East and South Asia.[28] The heart of the matter is that cross-border commerce in the developing world is throttled by the protectionist barriers that developing countries erect against their equally poor or even poorer neighbours. Will new PTAs make a big dent in these barriers and thereby spur regional and global economic integration? This looks doubtful.

d) The role of donors[29]

Foreign aid, with conditions attached by the IMF, World Bank and other donors, has clearly played a big part in driving Washington Consensus-type

[27] World Bank, *Global Economic Prospects 2005: Trade, Regionalism and Development*. Washington, DC: World Bank, 2004, ch. 6.

[28] Sally R, 'FTAs and the prospects for regional integration in Asia', *ECIPE Working Paper* No. 1, 2006c, http://www.ecipe.org/publications/2006/WPno1_06_Sally.pdf.

[29] This section draws on Erixon F & R Sally, 'Trade and aid: Countering New Millennium Collectivism', *Australian Economic Review*, 39, 1, 2006, pp.69–77.

reforms in many developing countries. This has gone way beyond developing countries' (relatively weak) liberalising commitments in the WTO and PTAs/FTAs. Arguably, unilateral liberalisation has not been truly 'unilateral' when it has depended on donor policy preferences and aid with strings attached. The record of IMF stabilisation packages and World Bank structural adjustment packages has been mixed at best, and certainly disappointing compared with optimistic expectations in the 1980s.[30] Often donor-driven reforms have proceeded in stops and starts, with reversals en route. Projected growth and poverty-alleviation effects have not materialised. The politics of aid is even more dubious than its economics. 'Conditionality' is empty rhetoric when self-serving interests at both ends of the pipeline ensure that aid continues to flow, even when promised reforms are not delivered. And the perception that Western donors are imposing reforms on otherwise reluctant countries is hardly sustainable: local 'ownership' is lacking (to borrow aid jargon), and it invites a backlash and reform reversal at home.[31]

The bottom line is that countries that have seen strong, sustained, unilateral liberalising reforms are those whose governments have driven reforms ('from below', as it were) rather than having them imposed by donors ('from above'). Aid at its best has smoothed short-term adjustments; and donor conditionality has provided a 'good housekeeping seal of approval' – an international signal of reform credibility – more than anything else. In these countries (most in East Asia and Eastern Europe, and a few in Latin America), aid has not been central to reform success. Where there has been more reliance on aid and donor conditionality, reforms have a far worse record. This applies to Africa in particular.

Seen in this light, the new conventional wisdom on aid is wrong-headed and dangerous. The UN Millennium Project and the Africa Commission Report both propose to double or even triple aid between 2005 and 2015, particularly with Africa in mind. The UN idea – or rather, Jeffrey Sachs's idea – is a new version of the old principle of aid: poor countries lack resources to invest, and donors have to fill this 'financing gap' with a 'big push' of investment if growth

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30 World Bank, *Assessing Aid: What Works, What Doesn't, and Why*. New York: Oxford University Press, 1998a; World Bank, *1998 Annual Review of Development Effectiveness*. Washington, DC: World Bank Operations Evaluation Department, 1998b.

31 Bauer PT, 'Foreign aid: Abiding issues', 2000b, in Bauer PT, 2000a, *op. cit.*

is ever to occur.[32] A sudden and massive increase of aid threatens to repeat past mistakes and provide extra incentives to delay and derail, not promote, market-based reforms. Available evidence shows that aid does not improve the productivity of investment; it diverts funds to stimulate government consumption and current spending; it has a negative impact on domestic savings; and, by expanding the role of already dysfunctional governments, it breeds waste and corruption. In short, this approach is misguided top-down intervention.[33]

A softer version of aid optimism, associated with the World Bank, assumes that countries are poor because of bad policy choices and weak institutions, and that aid can lock in already accomplished reforms and facilitate additional reforms.[34] This view is politically naive, though a convenient fiction for elites who profit from the aid business. The main objection is that aid has not and probably will not be a good midwife to market-based reforms. On the contrary, aid is given more often than not to support failed policies; and there is a high incidence of repeat lending to governments without a good track record of market-based reforms.

A particular version of the aid-to-reform idea is the 'aid-for-trade' scheme that is now discussed in the Doha Round. No one has yet defined how it will work. Is it a structural adjustment programme, an unemployment insurance programme, a budget support programme, an industrial promotion programme, or something else? Whatever the purpose, the history of aid warns us of the perils of such a scheme. Moreover, the idea that countries should be protected from the market-based structural adjustment that trade liberalisation entails is in direct conflict with the reality of development.

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32 UN Millennium Project, *Investing in Development: A Practical Plan to Achieve the Millennium Development Goals*. New York: Earthscan, 2005; Sachs J, op. cit.; Easterly W, 'The ghost of the financing gap: Testing the growth model used in the international financial institutions', *Journal of Development Economics*, 60, 1999, p.2.

33 Easterly W, *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done so Much Ill and so Little Good*. New York: Penguin, 2006.

34 World Bank, 1998a, *op. cit*.

e) Preliminary summary

Strong reforming countries have relied overwhelmingly on unilateral liberalisation. This has sometimes translated into stronger multilateral commitments and more flexible, pragmatic participation in the WTO. China and Vietnam are the textbook examples. But further substantial liberalisation through trade negotiations, whether in the WTO or PTAs/FTAs, is unlikely. More likely unilateral liberalisation will be the primary engine, and it will come mainly from China. This will induce competitive emulation elsewhere – a ripple effect of trade and FDI liberalisation – but largely outside trade negotiations. That still leaves room for the WTO and PTAs/FTAs, but these are at best second instances of trade policy. The WTO in particular can be a helpful auxiliary, perhaps less in driving a liberalisation agenda and more as a set of enforceable non-discriminatory rules for international commerce, not least to assist developing-country governments in undertaking market-based reforms. Finally, aid-induced liberalisation has not really worked: its political economy is highly dubious. Hence, it is a mistake to rely even more on aid for further market-based reforms.

5. WHAT LESSONS FOR FUTURE LIBERALISATION?

To recapitulate: the conditions for further liberalisation and associated structural reforms are more difficult today than they were in the heyday of the Washington Consensus. Reform complacency results from a post-crisis environment of buoyant growth and normal interest group politics. There is dissatisfaction with previous reforms in parts of the developing world. Some anti-liberalisation ideas are enjoying a minor revival. Lastly, the politics of 'second-generation' trade policy reforms is proving much more difficult than that of 'first-generation' reforms. The latter involve the reduction and removal of border barriers. This is relatively simple technically and can be done quickly – though politically these measures are rarely easy. The former are all about complex domestic (though trade-related) regulation, such as services regulation, regulation of food-safety and technical standards, intellectual property protection, public procurement, customs administration and competition rules. These reforms are technically and administratively difficult, and take time to implement. They demand a minimum of capacity across government, especially for implementation and enforcement. Above all, they are politically very sensitive, as they affect entrenched interests that are extremely difficult to dislodge.

Still, there is a strong case for further market-based reforms in general, and for external liberalisation in particular. Reduction of what are still high barriers to trade, foreign investment and the cross-border movement of people holds out the promise of higher growth, and significant poverty reduction and improvements in human welfare. Stalled reforms and reform reversal threaten to deprive hundreds of millions of people of the life chances they deserve. These are the stakes. Against this backdrop, the following challenges lie ahead.

a) 'First-division' reformers

These are the 20–25 developing countries – the 'new globalisers' – that have already gone far with macroeconomic stabilisation, and internal and external liberalisation. They have plugged themselves into globalisation. Their task is to go further with dismantling border barriers to trade and opening the door to FDI. But their bigger challenge is to make much more progress on trade-related domestic reforms – the 'structural' and 'institutional' reforms where progress to date has been too slow. This entails tackling the second-generation issues mentioned above. What is needed is a culture of permanent, incremental reforms, mainly of the second-generation variety, that build on the foundations of first-generation reforms, so that the economy adapts flexibly to changing global conditions. That is easier said than done. The great difficulty lies in doing serious reforms in conditions of normal interest group politics, without an economic crisis to concentrate minds. But the alternative is creeping sclerosis in times of plenty, and excessive reliance on a crisis for the next reform wave.[35] That cannot be good for long-term political, social and economic health.

Such are the broad trade policy priorities for first-division developing countries. In this context, the following points deserve emphasis.

Firstly, there needs to be a clearer link between trade policy, on the one hand, and domestic economic-policy and institutional reforms, on the other.

[35] Olson M, *op. cit.;* OECD (Organisation of Economic Cooperation and Development), *Economic Policy Reforms: Going for Growth.* Paris: OECD, 2007.

Trade policy should be coupled strongly with competition-friendly measures to improve the domestic business climate. It should be better hitched to domestic reforms. For example, there should be ways of linking trade and FDI liberalisation, and trade-related regulatory reform to measures to shorten and simplify regulations that hinder business at home. Such red tape includes procedural hurdles to overcome before starting a business, dealing with various licensing procedures, registering property, getting access to credit, employing workers, bankruptcy procedures, and time taken to clear goods through customs. These regulations are documented, classified and ranked in the World Bank's annual Doing Business report.[36]

Second-generation trade policy reforms also depend on the quality of public administration and the rule of law (i.e. the quality of the legal framework governing property rights and contracts, and their enforcement by the judicial system). These relate to some of the World Bank's governance indicators and cross-country rankings. (See Tables 10–12 for inter-country differences in business costs and governance.)

Secondly, and following directly from the previous point, trade policy should be seen less through the prism of trade negotiations and international organisations, and (as argued above) more through the prism of the domestic economy. Second-generation reforms in particular are bundled up with domestic politics and economics, initiating and implementing them is overwhelmingly a domestic affair, and the scope for productive international negotiations and solutions is restricted. That is already becoming evident with the regulation of services trade and trade-related product standards, and of policies towards inward investment. It will become even more evident as global production networks and the movement of people across borders bite ever deeper into domestic institutions.

As trade policy becomes ever more entwined with domestic policies and institutions, it follows that there should be more reliance on unilateral measures, including external liberalisation, and correspondingly less reliance on reciprocal liberalisation through the WTO and PTAs. Unilateral reforms should then be locked in through stronger WTO commitments. This should be the foundation for advancing national market-access and rule-making interests

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[36] World Bank, *Doing Business in 2007*. Washington, DC: World Bank, 2006.

in the WTO. Governments should also exercise caution with PTAs, avoiding quick and dirty ones and only engaging in those that are comprehensive, WTO-plus, and clearly linked to competition-enhancing domestic reforms.

Thirdly, there should be much more policy transparency. Trade policy making is usually opaque. Too little is known and understood about the effects of this or that set of trade policies. Consequently, public discussion of policy choices is usually uninformed and misguided. One should add that this applies almost as much to developed countries as to developing countries. For example, anti-dumping and rules-of-origin procedures in the EU are shrouded in secretive, discretionary and ultimately arbitrary behaviour, with restricted external access to information. The situation is not much better elsewhere.

What is lacking is what Patrick Messerlin calls a 'culture of evaluation'.[37] Independent think tanks and even government bodies should do much more detailed research and analysis on the costs and benefits of trade policies in different sectors of the economy, and then disseminate findings to the public. This would facilitate more informed, intelligent public discussion of policy choices.[38] One model to examine is that of the Australian Productivity Commission (formerly the Tariff Board).

This is a governmental body, but it is independent and has statutory powers. It provides research and analysis on trade-related issues in Australia, and its conclusions do make their way into the public debate. The Tariff Board's ground-breaking work did much to reveal the costs of protection to the Australian public back in the 1970s, at a time when Australia was a highly protected economy. This generated much public discussion at the time, and in many ways prepared the ground for the radical opening of the Australian economy in the 1980s. Such 'transparency boards' could be set up at relatively low cost in developing countries.

Taken together, these reform priorities are as much about *simplicity* and *transparency* as they are about *liberalisation*. The case for transparency has been made above. Simplicity is all about making complex bureaucratic procedures

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37 Messerlin P, *Europe after the 'No' Votes: Mapping a New Economic Path*. London: Institute of Economic Affairs, 2005.

38 This is the headline objective of the European Centre for International Political Economy (ECIPE), the new Brussels-based think tank I run with Fredrik Erixon. See our mission statement at http://www.ecipe.org. And sheepish apologies for this personal plug.

shorter, more predictable, and also more transparent. This would lessen the costs of doing business – for domestic *and* foreign traders and investors. Hence the importance of linking trade policy to nitty-gritty domestic reforms.

Fundamentally, these reforms boil down to restructuring the state, away from the large overactive state that intervenes badly across the range of economic activity, and towards the limited state that performs a smaller number of core functions well. The latter should focus on providing and enforcing a framework of rules for market-based competition. To use Michael Oakeshott's distinction, the state should be an 'umpire' of a 'civic association', not an 'estate manager' of an 'enterprise association'.

b) 'Lower-division' reformers

These countries, overwhelmingly in the low-income and least-developed bracket, have higher border barriers than first-division reformers, in addition to bigger domestic obstacles to trade and investment. They are less globalised. Their first priority should be to reduce border barriers and simple non-border barriers (such as some red-tape procedures that give them low rankings in the World Bank's Doing Business report). They have less capacity than first-division reformers for implementing more complex second-generation reforms. These could wait until the easier reforms are done. The real dilemma is that countries at the bottom of this pile, especially among the least developed countries, are mired in political instability and civil strife, with failed and failing states that do not perform the most basic public functions. Such countries do not have the capacity to implement even simple reforms. Aid-driven solutions have failed, but what is the substitute?

c) Reform fatigue

All countries face reform complacency and fatigue. But labour-abundant countries that have inserted themselves into global production networks are most likely to have interest group coalitions and institutions to defend existing open-market reforms and promote further reforms. Resource-abundant countries have a weaker political economy base. They are more likely to let reforms lapse and squander the rents from commodity booms. They are doubly challenged in building coalitions of interests to keep reforms going, and to strengthen institutions so that wealth is both generated sustainably and spread widely.

d) Other policy challenges

Several other policy challenges come to mind, all directly or indirectly related to trade policy. Here is a brief list of relevant questions, with equally brief answers.

1) How should trade policy reforms be sequenced with other reforms, such as those relating to macroeconomic policy? Should reforms be fast or gradual?
There are no general answers to these questions. They depend on circumstances, and expediency will dictate different answers in different places at different times. What matters more is the general thrust: a medium- to long-term commitment to liberalise in the direction of a market-based, globally integrated economy.

2) What is the link with political systems? Is democracy or authoritarianism better suited to market-based policy reform? Do such reforms have a better chance under right-wing or left-wing governments?
Again, there are no general answers. For every example to support one thesis, there is a counter-example to support the opposite thesis. Reforms have succeeded in widely differing political systems, and under governments of different political hues, just as they have failed across the spectrum of political systems and partisan politics.

3) What role is there for industrial policy?
There is leeway for experimentation, adapted to different local conditions. Economy-wide measures, such as improving transport and communications infrastructure, as well as education and skills, can dovetail with trade and wider economic policy reforms. So can other 'soft' measures such as trade and investment promotion through information dissemination, organising trade fairs and the like. But selective promotion and protection of this or that industry has a questionable record; and 'hard' industrial policy of the 'picking winners' variety has an abysmal record. It should be avoided.

4) What about social policies?

Are social safety nets needed alongside liberalising reforms? How generous should they be? Should 'losers' be compensated? These questions of distribution and equity elicit quite different responses. The classic liberal response is to keep government limited, focused on its role to provide and enforce a framework of rules for an open, competitive market economy. Basic social safety nets should be provided where affordable. Beyond that, the classic liberal has little interest in redistribution. In contrast, the social democratic response is to give high priority to redistribution, with government playing an active role.

These debates have taken place mostly in developed countries, but they are, of course, relevant to developing countries. On the one hand, developing countries have less financial scope for redistribution compared with developed countries. They also have bigger institutional constraints. Ambitious social policies risk scattering scarce resources that should be focused on liberalising reforms. On the other hand, big and widening differences between income groups and regions could undermine popular acceptance of core reforms.

Here also there are no easy, general blueprints. There is room for experimentation and trial-and-error learning. But one thing is needed: better delivery of existing public services, including the provision of social safety nets. These are the last bastions of the command economy. Administrative mechanisms squander public funds and fail to serve those most in need. More market mechanisms are needed, including competition from private sector suppliers of services. That also opens up possibilities for trade, FDI and cross-border labour movement in traditional public services such as health care, education and the utilities, and even beyond to cover housing, social security and pensions. These 'third-generation' reforms are the next frontier.

6. CONCLUSION

The naysayers, from the hard and soft left, and the conservative right, hold that liberalisation has not delivered the goods. They argue for various forms of government intervention, at national and international levels, to tame 'market fundamentalism' and 'neo-liberal globalisation'. Interventionist ideas on trade (and aid) are not new; they hark back to pre-Adam Smith, 'pre-analytic' mercantilism (as Schumpeter called it). What they have in common is an age-old distrust of markets and faith in government intervention – what David Henderson calls 'New Millennium Collectivism'.[39] Such collectivist thinking is on the rise again. But it is still wrong and dangerous. It glosses over the damage done by interventionist policies in the past, and misreads the recent and historical evidence.

The latter shows that external liberalisation, as part of broad market-based reforms, has worked: countries that have become more open to the world economy have grown faster and become richer than those that have opened up less or remained closed.

There is much unfinished business. Barriers to trade and to the cross-border movement of capital and people remain high; indeed more so in developing countries than in developed countries. But a combination of material circumstances and changes in the climate of ideas makes market-based reforms more difficult now than was the case a decade ago. The stakes, however, are too important for reform challenges to be avoided. While there is no imminent threat of global economic collapse, stalled reforms threaten to slow down globalisation's advance, thereby depriving the world's least-advantaged people of the life chances that globalisation offers. That would reinforce strong pressures from an alliance of old-style protectionist interests and new-style ideological forces for overactive government to restrict economic freedom and the operation of the market economy. That is why new old-collectivist ideas need to be countered with full force.

Thus, it falls to friends of the market economy to make a strong case for further reforms, including external liberalisation, and practically go about assembling reform coalitions. To borrow J S Mill's felicitous phrase again, they should spread their word *in season with* global political currents, anti-protectionist producer and consumer interests, and (often unanticipated) events.

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[39] On the provenance and progress of these ideas, see Henderson D, Anti-Liberalism 2000: The Rise of New Millennium Collectivism. London: Institute of Economic Affairs, 2001.

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