The bicycle treadmill needs a break

Why NAMA negotiations are dangerous for development and environment

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Content

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1. Summary

In December 2005, the Ministerial Conference of the World Trade Organization (WTO) will presumably conclude the NAMA negotiations in Hong Kong. These negotiations are putting industrialization in developing countries at risk. They will lead to more poverty and endanger a sustainable management of natural resources. Policy spaces are narrowed down making democratic decision-making on economic issues a paper tiger. Current levels of liberalization are fully adequate. For these reasons, critics are demanding a stop to negotiations.[1]

2. What did and should happen on the way to Hong Kong?

After the breakdown of the Ministerial Conference in Cancún, Mexico, in September 2003, WTO members decided that they have a lot of catch-up work to do in order to compensate for the Cancún failure. These efforts stand to cumulate in the successful conclusion of the Ministerial Conference in Hong Kong between 13th and 18th December 2005.

In these negotiations the industrialized countries aim at a far-reaching lowering of tariffs for industrial goods in the so-called non-agricultural market access (NAMA) negotiations.[2] The United States is even insisting on completely free trade on a worldwide scale until 2015. A difference has already been made by a decision on a technical issue. A formula-based tariff cut is envisaged which may induce a much more intense liberalization than the Uruguay Round, which led to the establishment of the WTO.[3]

In calling for this speed and intensity of liberalization, several aspects are brushed aside. The decision makers neglect that this threatens the survival of industrial sectors in developing countries and that poverty and unemployment may rise as a consequence. Furthermore, the suggested liberalization in the NAMA framework encompasses natural resources (fishery, forests and minerals). This is the second reason why people are worried. A higher grade of liberalization in this field will lead to an

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[1] See the following NGO publications on NAMA: ActionAid. Bound and tied. The developmental impacts of industrial trade liberalization at the World Trade Organization. 2005. In: http://www.actionaid.org; Hilary, John. The Doha Industrialization Agenda: Non-Agricultural Market Access Negotiations at the WTO, April 2005. In: http://www.waronwant.org; Forum Umwelt und Entwicklung, Greenpeace, Evangelischer Entwicklungsdienst, WEED. Das NAMA-Drama. Wie die WTO-Verhandlungen über Industriegüter Umwelt und Entwicklung bedrohen. Oktober 2005. In: http://www.forumue.de.

[2] Basic information in: Kohr, Martin, Goh, Chien Yen. The WTO Negotiations on Non-Agricultural Market Access: A Development Perspective. November 2004. In: http://www.twnside.org.sg. (quoted as Kohr/Goh 2004); see further: Akyüz, Yilmaz. The WTO Negotiations on Industrial Tariffs: What is at stake for developing countries? Geneva: May 2005. In: http://www.twnside.org.sg/akyuz.htm. (quoted as Akyüz 2005); and: de Córdoba, Santiago Fernandez, Laird, Sam, Vanzetti. Trick or Treat? Development opportunities and challenges in the WTO negotiations on industrial tariffs. David. Draft 10 May 2004. UNCTAD Trade Analysis Branch: http://192.91.247.38/tab/Default.asp. (quoted as de Córdoba et al. 2004)

[3] The aim is a formula-based tariff cut in tariff positions which affects every single tariff position in contrast to an average cut in the Uruguay Round. The latter implied line-by-line negotiations on peak tariffs which could end by leaving certain tariff lines untouched. In addition, it is now demanded that all tariff levels should be bound at ceiling levels according to WTO rules. Akyüz 2005: 4-5.

increasing trade in and exploitation of scarce natural resources and will hinder the government's ability to use trade measures to manage stocks sustainably.

In spite of a wide gap between the positions of industrialized and developing countries, there is some movement in the negotiations because particular interests may find common ground. Some large developing countries would like to gain better market access for their agricultural products, for example, Brazil's sugar. The Brazil example is paralleled by India, who is not indifferent towards services. Thus it may not be completely impossible to bridge the gap between industrialized and developing countries and it may become easier to explain why the negotiations continue despite major differences between the positions of these two country groups.

Briefly, the NAMA negotiation history, so far, goes as follows: During a meeting of WTO's General Council on 31st July 2004, a framework for the bargaining process was negotiated (July package) which made it possible to concentrate the struggle on concrete details and numbers ('modalities') later on. Afterwards, negotiations were stalled. A good example is the recent meeting of the General Council between 27th and 29th of July 2005 in Geneva. Somewhat later the Mini-Ministerial in Dalian, China, ended inconclusively.[4]

Dubiously enough, the negotiations were regaining momentum when industrialized countries successfully divided up developing countries by narrowing down the number of countries involved in the negotiations to a group of 'five interested parties, FIPS'.[5] The developing countries participating in this group are Brazil and India. This is not surprising as these countries are the main targets for tariff reduction demands while at the same time being interested in better access to the markets of industrialized countries in the field of agriculture and services. In principle, these five countries can reach a settlement alone, which could be extended to the other WTO Member States, while the latter then may not be able to change central parts of this deal. Still, the constellations are fluctuating in the negotiation process and on certain occasions developing countries rely on their more inclusive G-20 group.[6] In this broader group four member states are from Africa. Nevertheless, it is difficult for many smaller developing countries to influence the negotiations in a meaningful way.

Whether this last statement is true or not will be clarified by the African Cotton Initiative of the four West African countries Benin, Burkina Faso, Tschad und Mali in the weeks leading up to Hong Kong.[7] Their aim in the negotiations is the abolition of cotton subsidies, including export subsidies. Many African countries successfully produce cotton or will be able to start production before long. However, cotton subsidies in the United States, the EU and China have led to very low world market prices and massive revenue losses for Africans. If these countries were to meet these very justified

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[4] To Dalian, China were invited: Egypt, Argentina, Australia, Bangladesh, Barbados, Benin, Brazil, Canada, Chile, Columbia, Costa Rica, the European Union, Hong Kong, India, Indonesia, Jamaica, Japan, Kenya, Korea, Malaysia, Mexico, New Zealand, Nigeria, Pakistan, Ruanda, Singapore, South Africa, Switzerland, Thailand, the USA und Zambia.

[5] The following countries belong to the FIPS group: Australia, Brazil, India, the European Union and the United States of America. On 23 September these actors meet in a “New Quad” (EU, US, Brazil, India) constellation in Paris. Afterwards another FIPS meeting is expected ("New Quad" plus Australia) and moreover, a meeting of an enlarged FIPS group (with Switzerland and Malaysia).

[6] The G-20 consists of: Argentina, Brazil, Bolivia, China, Chile, Cuba, Guatemala, India, Indonesia, Mexico, Pakistan, Paraguay, Philippines, Egypt, South Africa, Nigeria, Tanzania, Zimbabwe, Thailand, Venezuela. See: http://www.g-20.mre.gov.br. There are slight changes concerning the members. Shortly before Cancún, El Salvador, Cuba, Pakistan joined, after Cancún, Columbia, Peru, El Salvador and Costa Rica left the group due to pressure from the USA.

[7] See: http://www.wto.org/english/tratop_e/agric_e/cotton_subcommittee_e.htm. And see: Sumner, Daniel A. Reducing Cotton Subsidies: The DDA Cotton Initiative. In: Anderson, Kym, Martin, Will. Agricultural Trade Reform and the Doha Development Agenda. Washington: World Bank, 2005. In: http://www.worldbank.org.

demands, a broad-based and effective poverty reduction would be the outcome in many African countries, which would help to reach the Millennium Goals of poverty reduction. Nevertheless, the fate of this initiative remains unclear. Although Benin, Nigeria, Kenya and South Africa were invited, this initiative was not even mentioned in the Co-Chair's summary of the Mini-Ministerial in Dalian, China.[8]

Since 1st September, the new Secretary General of the WTO is Pascal Lamy. His job is to oversee the extensive work programme in preparation for the Hong Kong Ministerial, a programme which began on 19th September. The European Union and the United States hope that his conciliatory work will lead to a much speedier decision-making process than before. Experience shows that, in the days to come, developing countries and WTO-critical NGOs will be blamed as 'obstructors' of negotiations although they do have justified concerns in the field of development and the environment.

3. Insecurity about promised welfare gains

International trade *can* increase world welfare. Still, publicly, it is pretended that this relationship is sure and simple. Repeatedly it is argued that the reduction of tariffs will inevitably lead to welfare increases and large sums of money are mentioned to make people dizzy (between US$ 108 billion und US$ 370 billion).[9] These sums are calculated with general equilibrium models.

Assuming for the moment that these models give a rough idea of what will happen in reality[10], it comes as a surprise that the public is unaware that these models not only forecast welfare gains but also massive changes in the structure of production in certain countries. For example, India will lose 3.4% and Vietnam 13.3% of its output if agricultural trade is fully liberalized.[11] In a free trade simulation, Sub-Sahara Africa suffers an output reduction of -5% in chemicals, -14% in leather and -6% in clothing.[12] In the automobile sector, China loses -18% , India -6% and other countries of South Asia are even deprived of -47% of their output in the automobile sector plus -19% in the field of motorcycles.[13] Clearly, this can have negative consequences for the industrialization efforts of these countries.

The results of general equilibrium models are heavily disputed because in most cases only static effects are measured, i.e. a reorientation of production factors according to newly established comparative advantages. Costs implied by this reorientation are not measured. Similarly, it is

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[8] Informal Ministerial Meeting, Dalian 12-13 July 2005. Co-chairs' Summary. In: www.ictsd.org/infosrc/ministerial/hongkong/Dalian_IMM_Co-chairs_Summary-Final_Version.pdf.

[9] Overview in Cline, William R. Trade Policy and Global Poverty. Washington, D.C.: Institute of International Economics, 2004. (quoted as Cline 2004); see for a much more sceptical general equilibrium investigation: Bouet, Antoine, Bureau, Jean-Christophe, Decreux, Yvan, Jean, Sebastian. Multilateral agricultural trade liberalization. The contrasting fortunes of developing countries in the Doha Round. CEPII Working Paper, No. 18 November 2004. In: http://www.cepii.fr. (quoted as Bouet et al. 2004)

[10] WTO authors cautiously conclude: "The numbers that come out of the simulations should only be used to give a sense of the order of magnitude that a change in policy can mean for economic welfare and trade. But much more can be done to create confidence in the results." Piermartini, Roberta, Teh, Robert. Demystifying Modelling Methods for Trade Policy. Discussion Paper No. 10. Geneva: World Trade Organization, 2005. In: http.//www.wto.org. p. 53. (quoted as Piermartini/Teh 2005)

[11] Anderson, Kym, Martin, Will, van der Mensbrugghe, Dominique. Market and Welfare Implications of Doha Reform Scenarios. In: Anderson, Kym, Martin, Will (eds.). Agricultural Trade Reform and the Doha Development Agenda. Washington: World Bank, 2005. In: http://www.worldbank.org. p. 48.

[12] de Córdoba et al. 2004: 10-11, 27.

[13] de Córdoba et al. 2004: 27.

disregarded that existing industries can successfully develop in a dynamic manner. In addition, a full liberalization in the fields of both agriculture and industry is often taken for granted although this scenario is unlikely.[14]

Moreover, on a more fundamental level, it is doubtful whether a static, neoclassical view which is the foundation of the general equilibrium models is able to describe economic processes in a plausible manner. The sometimes hidden, but prevalent view in economic science is that economic processes are dynamic and rely on a broader set of causal influences than the neoclassical view allows for. Among those causal influences are the diffusion of technology and increases in productivity which are based on the acquisition of technological capabilities.[15] Industrialized countries' speciality is that firms have been embedded by the state in both a risk-inducing and risk-mitigating framework. Although there are different degrees of competition, risks are partially mitigated, for example by accepting the diffusion of technology, by subsidizing research and development and by providing a pool of well-educated experts.[16] This welfare enhancing risk management arrangement, of which developing countries have insufficient command of, is the key factor for the success of industrialized countries after the Second World War.

It does not follow from this dynamic view that only a full liberalization of world trade leads to optimum welfare increases. World market prices certainly play an important role but they are not the only means by which optimal welfare improvements may be achieved. At least to a certain degree – as supplement and completion of the neoclassic scenario – worldwide welfare increases are based on dynamic processes of economic growth which happen as internal, home-made dynamics in many countries throughout the world.

Seen from this perspective, certain ambitious negotiation proposals can be rejected from the point of view of the global common good. Why? Simply because it is more welfare-enhancing to combine liberalization and world market price incentives and the force of an internal, home-made dynamism without suppressing the latter. Developing countries conceding to full liberalization while disregarding internal dynamism would agree to a 'lock in' with a potentially less welfare enhancing outcome. Production would be allocated solely by world market prices. Many industries will have to give up and a new focus on labour- and resource-intensive sectors is likely, which at least in some instances can be characterized by low value added and low productivity growth.[17] Furthermore, as countries are fully integrated into the production networks of international firms, growth options based on national

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[14] This critique in: Vanzetti, David, McGuire, Greg, in collaboration with Prawobo. Trade Policy at the Crossroads - the Indonesian Story. United Nations Conference on Trade and Development. Trade Analysis Branch. Policy Issues in International Trade and Commodities Study Series No. 28. United Nations: New York and Geneva, 2005. In: http://192.91.247.38/tab/Default.asp. p. 22-23. (quoted as Vanzetti et al. 2005); similarly critical Akyüz 2005: 31-35.

[15] See from the field of growth accounting: Maddison, Angus. Monitoring the World Economy 1820-1992. Paris: OECD, 1992. p. 33-57; from the perspective of competition policy theory: Scherer, F. M., Ross, David. Industrial market structure and economic performance. Third Edition. Boston: Houghton Mifflin, 1990; these authors model dynamic processes: Nelson/Winter 1982: Nelson, Richard R., Winter, Sidney G. An Evolutionary Theory of Economic Change. Cambdrige, Mass.: The Belknap Press of Harvard University Press, 1982. p. 315, 341-342, 401. Already in 1776, Adam Smith described temporary advantages of firms due to technological change and the increase in productivity caused by mass production ('pin example') in Smith, Adam. Der Wohlstand der Nationen. (Hrg.) Recktenwald, Horst Claus. München: dtv, 1999. p. 9-10, 53.

[16] Ha-Joon Chang calls this phenomenon "socialization of risk" because firms engage in riskier ventures than they would have done without these arrangements. Without these arrangements they would act autonomously, like liberal theory is conceiving them. According to Chang, more direct industrial policy like restructuring but also R&D support belongs to this 'socialization of risk' arrangement. Chang, Ha-Joon. The Political Economy of Industrial Policy. New York: St. Martin's Press, 1994. p. 78-79. This is compatible with the insights and arguments of Lall, Sanjaya. Technological Capabilities and Industrialization. In: World Development, Vol. 20, No. 2, 1992. p. 165-186.

[17] Choudri/Hakura 2000: 3-4, 10, 13-14.

economic structures will be foregone. This is even more deplorable as a more diversified economic structure may simplify a successful integration into world markets.

Some of the general equilibrium models include dynamic effects. Surprisingly, this is not used to achieve a more realistic simulation of adjustment effects. The World Bank model (Global Economic Prospects, 'GEP') is based on the simple assumption that liberalization increases productivity growth although this relationship is much more complex in reality.[18] Based on this optimistic conjecture, the World Bank calculated massive welfare improvements for developing countries of US$ 830 billion due to both a full liberalization in agriculture and industry and a complete abolition of subsidies (agriculture has the biggest share in these welfare gains, US$ 587 billion).[19]

However, welfare effects in the field of agriculture reached by full liberalization are a particularly problematic indicator of success. In specialist literature, poverty reduction in least developed countries is attributed to the selective agricultural liberalization measures of industrialized countries, which are targeted at sectors where LDCs have supply capacity, for instance cotton in Africa.[20] Moreover, whether you like it or not, the fact remains that full agricultural liberalization is unlikely because of the weight interest groups hold in industrialized countries. In addition, the underlying question is whether agricultural liberalization makes any sense at all. As long as industrialized countries use subsidies *and* world market price levels for rice, wheat and maize are low because technological progress allows cheap production, it may continue to make sense that developing countries use flexible tariffs to stabilize local price levels because under certain circumstances this can reduce poverty.[21]

The only general equilibrium model which addresses the problem of losses of government revenues because of tariff cuts led to an ambivalent conclusion. The model predicts that consumers in developing countries benefit from lower prices following tariff reduction (US$ 244 billion). At the same time, governments may be forced to raise taxes to compensate for their shortfall of tariff revenues, here an estimated US$ -226 billion. In short: positive and negative effects offset each other. Why is this question important? Because in more than 50 developing countries tariffs amount to more

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[18] With regard to countries which mostly sell traditional, slowly growing export products (here agriculture, paper, other manufactured products), for example Sub-Sahara Africa, it can be shown that trade is not connected with productivity increases. This relation is more likely if countries have a larger manufacturing sector. Choudhri/Hakura 2000: Choudhri, Ehsan U., Hakura, Dalia S. International Trade and Productivity Growth: Exploring the Sectoral Effects for Developing Countries. IMF Working Paper, WP/00/17. In: http://www.imf.org.pp. 3-4, 10, 13-14 (quoted as Choudri/Hakura 2000); doubtful concerning a simple connection between trade and productivity growth: Rodrik, Dani, Francisco Rodríguez. Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-National Evidence, newly revised, May 2000. In: http://ksghome.harvard.edu/~drodrik/. pp. 36-43. More optimistic, but still differentiated: United States International Trade Commission. The Dynamic Effects of Trade Liberalization: An Empirical Analysis, Publication 3069, October 1997. In: http://www.usitc.gov. pp. 3-20, 3-21. Very different firm reactions on liberalization in India are shown by Aghion, Philippe, Burgess, Robin, Redding, Stephen, Zilibotti, Fabrizio. The Unequal Effects of Liberalization: Theory and Evidence from India. London School of Economics, Harvard University. 3 October 2003. In: http://econ.lse.ac.uk/staff/rburgess/wp/abrz031002.pdf. (quoted as Aghion et al. 2003)

[19] World Bank. Global Economic Prospects and the Developing Countries. Washington: World Bank, 2002. pp. 166-167.

[20] UNCTAD. The Least Developed Countries Report. New York, Geneva: United Nations, 2004. In: http://www.unctad.org. pp. 223-227.

[21] The IFPRI Institute advised Egypt to re-negotiate its agricultural tariffs in order to use flexible tariffs in the future to maintain higher than world market prices on the the domestic wheat market. Kheralla, M., Löfgren, H., Gruhn, P., Reeder, M. Wheat Policy in Egypt. Adjustment of Local Markets and Options for Future Reforms. Washington: IFPRI, 2000. pp 5, 9, 147, 153-154. Although large parts of the population benefit from lower prices, it is not always the case that the majority of farmers are net food consumers, who, in principle, may profit from lower food prices. For example, in Morocco a tariff reduction for wheat is found to have poverty increasing effects for the majority of the rural population. Ravillion, Martin. Looking Beyond the Averages in the Trade and Poverty Debate. World Bank Policy Research Working Paper 3461, November 2004. In: http://www.worldbank.org. pp. 21-22. (quoted as Ravillion 2004); see for a similar case in Kenya: Hermanns, Uwe. Fighting Poverty after Agricultural Liberalization In Africa. In: Nord-Süd Aktuell, Issue 3-4 'Fighting Poverty', Institute for Comparative Overseas Studies, forthcoming November 2005. In: http://www.duei.de.

than 20% of budgetary revenues. Within the logic of this simulation, this self-defeating effect can be mitigated if a more moderate form of liberalization is chosen. Thus free trade is not the best solution.[22]

Preference erosion is another problematic side of the NAMA negotiations. This term refers to the favourable treatment certain developing countries receive from the EU and the US. For example, textiles and clothing from Sub-Sahara Africa can be imported tariff-free into the EU. Because rules of origin cumulation have recently been allowed, the South African region (South Africa, Madagascar, Mauritius, Lesotho, etc.) has the chance to build up an integrated textile and clothing production cluster in the next decade. The textile industry of South Africa was restructured and modernized, while still being tariff-protected. Preferences are important for Africa, of the top 25 countries which benefit from preferences there are 16 African countries.[23] One simulation model comes to the conclusion that preference erosion has negligible effects. But this conclusion is doubtful because the underlying assumption is that liberalization in other developing countries can compensate for the detrimental effects. It is hard to understand why this premise is regarded as realistic. It is well known that developing countries protect their labour-intense sectors vis-à-vis each other and this is not going to change if a compromise is found in Hong Kong.[24] In short: NAMA negotiations will have clearly discernible negative effects on the weakest and poorest countries of the world and it is even more absurd that political decisions have recently been made with exactly the opposite aim, namely to make preferences better usable than before.[25] Even the IMF is worried about this prospect.[26]

Finally, it is interesting to spend some time on the question of poverty reduction and trade. Here it can be noted that there is no generally applicable causality between poverty reduction and liberalization.[27] Not in all, but in many cases, poverty is only insufficiently reduced by economic growth. The reason for this is that often a large percentage of the poor live in rural areas and price levels for agricultural goods as well as for education and health have a major influence on their income.[28] Furthermore, it is not always the case that comparative advantages lie in the field of labour-intensive production. If mines or a more capital intensive agricultural production expands, there are less poverty-reducing

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[22] In this moderate scenario developing countries cut their tariffs by 50%. The overall welfare effects of this scenario lie at US$ 73 billion, only US$ 9 billion beyond the free trade scenario; data on share of tariffs concerning budget revenues in Kohr/Goh 2004: 20; the scenarios and welfare effects are taken from Dessus, Sebastien, Kiichiro, Fukasaku, Safadi, Raed. Multilateral Tariff Liberalization and the Developing Countries. OECD Development Centre Policy Brief 18. Paris: OECD, 1999. In: http://www.oecd.org. pp. 15-16.

[23] Preferences are, for example, important in the field of textiles and clothing, aluminium, flowers and fish products. ILEAP. Key Issues in the Doha Round Negotiations on Non-Agricultural Market Access: An African Perspective. ILEAP Workshop Paper, Toronto 2004. In: http://www.ileapinitiative.com. p. 54. (quoted as ILEAP 2004)

[24] The seriousness of these effects becomes clear when it is calculated that preference erosion will cost Bangladesh US$ 200 million, if it is moderately affected. Cline 2004: 218-219. The advice to preserve preferences was given by Mayer, Jörg. Not totally naked: Textiles and Clothing in a Quota Free Environment. Discussion Paper No. 176. Geneva: UNCTAD, 2004. In: http://www.unctad.org/en/docs/osgdp200410_en.pdf. (quoted as Mayer 2004)

[25] Similar conclusions in the carefully modelled general equilibrium simulation of Bouet 2004: 28.

[26] "With many preferential rates set at zero under recent schemes such as the African Growth and Opportunity Act (AGOA), Everything but Arms, or the European Union association agreements, a cut in MFN rates translates directly into a loss of preference." Fund Support for Trade-Related Balance of Payments Adjustments. Prepared by the Policy Development and Review Department, approved by Mark Allen, 27 February 2004. In: http://www.imf.org/external/np/pdr/tim/2004/eng/022704.htm. (quoted as IMF 2004)

[27] Ravillion 2004: 22. These are complex questions; it is futhermore doubtful that WTO negotiations will lift 620 million people out of poverty until 2015, which is calculated by Cline (2004). Hertel, Thomas W., Reimer, Jeffrey J. Predicting the Poverty Impacts of Trade Reform. World Bank, Policy Research Working Paper, No. 3444, November 2004. In: http://www.worldbank.org. (quoted as Hertel/Reimer 2004)

[28] This is the reason why many inhabitants of rural areas in China will get poorer in the future. Ravillion 2004: 19. Similar: Hertel/Reimer 2004: 1.

effects.[29] This is the reason why internal reforms, for example reforms with redistributive impact, can achieve poverty reductions.[30] This insight does not conform with the thesis that full liberalization must be envisaged in order to fight poverty.[31]

4. Globalization is at a crossroads in Hong Kong

Recent NAMA negotiations imply that globalization is at a crossroads. Therefore any possible outcome will mark a sea change for international economic relations. The outcome of the negotiations will show whether a deep and irreversible liberalization of trade, leading directly towards free trade, will characterize the years to come or whether political management of trade, at least to a certain degree, will still be possible in future. Only the second scenario will preserve policy spaces to attain developmental policy and poverty reduction goals by trade policy means.

The United States and the European Union have decided to strive for as much liberalization as they can get. It is perhaps even more important that, theoretically, they both agree on the general policy recommendation that liberalization is the optimal path to further the developing countries' welfare.[32]

This is not negotiation rhetoric but can be exemplified by looking at countries which recently acceded to the WTO. Their accession was only accepted on the condition that they lower their tariffs to very low and uniform levels and bind them without reservation.[33]

At present, the proposals of the NAMA negotiations imply that a country with an unweighted average bound tariff of 60% must lower it to an average of 7.1% according to the US expectations and to 15% if EU suggestions were to be pushed through.[34]

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[29] Winters, Alan. Should concerns about the poor stop trade liberalization? Annual World Bank Conference on Development Economics, Paris 2000. In: http://www.worldbank.org. p. 7. (quoted as Winters 2000a)

[30] Ravillion 2004: 22-23. Kohl, Richard. Conclusions to the Conference Volume. In: Kohl, Richard (Hrg.). Globalization, Poverty and Inequality. Paris: OECD, 2003. p. 114.

[31] This is based on the simple belief that a country must fully adapt its industrial structure to world market price levels to achieve long-term benefits. See Winters 2000a: 11. Supporters of this idea even think that big welfare increases can be expected if the industrial sector, which is most distorted, for example, as far as tariffs are concerned, is abolished. This makes it easy to justify considerable adjustment costs. Short-term protection measures are not accepted because they are suspected to undermine the credibility of reforms. Employment losses or options to restructure and modernize this industry are not considered. Winters, Alan. Trade, Trade Policy and Poverty: What are the Links? Background Study for World Development Report 2000/01. Draft 7 February 2000. In: http://siteresources.worldbank.org/INTPOVERTY/Resources/WDR/winters1.pdf. pp. 43-47.

[32] It is well known that the United States pursues its 'Washington Consensus' and the so-called private sector development (PSD) which advances privatization. Less often, it is admitted that the European Union is similarly convinced that "Trade is an engine of growth and poverty reduction: economies need to be open". See: Maxwell, Simon. The Washington Consensus is dead! Long live the (European) meta narrative! In: Nord-Süd Aktuell, Jg. XVIII, Nr. 4, 2004. p. 685.

[33] The reader is kindly asked to trust my casual overview of accession documents of countries as different as Armenia, Bulgaria, Croatia, Estonia, Georgia, Jordan, Kyrgyz Republic, Latvia, Lithuania, Macedonia, Moldavia, Mongolia, Oman, Panama, Equador. The tariffs of acceding countries are all 100% bound, often at very low rates, an exception is agriculture. The highest tariff conceded for a smaller acceding country is Equador's automobile tariff of 30%, but this is an exception, even for Equador. Most tariffs are between zero and 10%, sometimes 20% is allowed. So far, Vietnam's and the Russian Federation's accession is still pending, among others.

[34] The Indian formula implies a less intense cut to a 40.2% average tariff rate. Even in this case developing countries would make clearly more concessions than industrialized countries because industrialized countries have already very low tariffs. Kohr/Goh 2004: 23; and see: de Córdoba, Santiago Fernandez, Laird, Sam, Vanzetti. Blend it like Beckham - Trying to read the ball in the WTO negotiations on industrial tariffs. 20 June 2004. UNCTAD Trade Analysis Branch: http://192.91.247.38/tab/Default.asp.

In other words, these NAMA requests of the United States and the European Union can no longer be supported by sound economic science. They can even be accused of doing exactly the opposite of what liberal theory envisages. They help interest groups in their search for a quiet life and high profits, namely international firms and internationally active wholesalers whose demands could decrease the global common good.[35]

The state-of-the-art research in economic science concerning the effects of liberal trade policies on developing countries is as follows: "It can be said with some assurance that extreme protectionist policies are economically harmful. But the case for free trade is not airtight (...)."[36] Furthermore, it is generally accepted that an export-oriented economic policy can be successful. Nevertheless, the impact of this policy is not only the result of a certain degree of liberalization but also of exchange rate devaluations and, last but not least, in many instances, of a manufacturing sector established during the period of import substitution (which was later transformed a second time by an more liberal incentive structure). In other words, selective tariff protection, for example, is compatible with export orientation. Furthermore, international trade is not only driven by comparative advantage but also by an exchange of similar goods. As a consequence, models of welfare maximization solely based on comparative advantage are not valid without qualification.[37]

So far, a remarkable level of liberalization has been achieved on a worldwide scale. On average, the level of applied tariffs levied by developing countries on manufactured goods from industrialized countries lies at 10.9% (vice versa 3.4%)[38]; in this overview only India and Mexico are on a higher level.[39] Looking at African countries, only Dschibuti, Kenya, Mauritius, Nigeria, and Zimbabwe, have average applied tariffs higher than 15.0%.[40] Thus, many developing countries in practice employ low or moderately high tariffs, with certain higher peaks. Therefore, one could arguably claim that the majority of countries already respect one important ingredient of export-oriented economic policy. For this reason alone, there is no urgent need to lower tariffs further and to bind them. By the way: the developing countries lowered their applied tariffs without a reciprocal response from the industrialized countries.[41]

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[35] Internationally active retailers can exercise market power locally and are therefore interested in entering the food and consumer goods markets of the big developing countries. Due to their global sourcing strategies, this endangers the development of the local food industry and is not positive for the consumer, therefore it is a clear case of rent-seeking, which decreases welfare. See: Cotterill, Ronald W. Food Retailing: Mergers, Leverages Buyouts, and Performance. Food Marketing Policy Centre, Research Report No. 14, September 1991. In: http://www.fmpc.uconn.edu. International firms are interested in preserving the oligopolistic constellations they are familiar with in order to have the quietest life possible under the conditions of globalization. So, this is rent-seeking too.

[36] Buffie, Edward F. Trade Policy in Developing Countries. Cambridge: Cambridge University Press, 2001. p. 5. (quoted as Buffie 2001)

[37] See for the concept of intra-industry trade Greenaway, David, Milner, Chris. The Economics of Intra-Industry Trade. Oxford: Basil Blackwell, 1986. One model of welfare optimization by international trade I am thinking of is the Pareto Heckscher Ohlin model.

[38] Hertel, Thomas W., Anderson, Kym, Francois, Joseph F., Martin, Will. Agriculture and Non-agricultural Liberalization in the Millennium Round. Global Trade Analysis Project, 1999. In: http://www.agecon.purdue.edu/gtap. p. 25.

[39] Applied tariffs, simple average, for 2003: Brazil 14.7%, China 9.7% (2004), India 30.8% (2001), Malaysia 8.0% (2002), Mexico 18.5%, Korea 7.8%, Taiwan 5.7%, Thailand 14.6% (2001), Tunisia 24.5%, Turkey 1.7%. Mayer 2004: 6; and see: WTO. Market Access. Unfinished Business. Geneva: WTO, 2001. pp. 17-19.

[40] ILEAP 2004: 73.

[41] It would be fair if countries who liberalized between WTO rounds of negotiations received credit for this in the negotiation afterwards. Mattoo, Aaditya, Olarreaga, Marcelo. Should Credit be Given for Autonomous Liberalization in Multilateral Trade Negotiations? Policy Research Working Paper No. 2374. Washington: World Bank, June 2000. In: http://www.worldbank.org.

Industrialized countries have definitely profited from this liberalization trend. From 1970–2003 exports of industrialized countries grew at a pace of 8.89% and imports rose by 8.86% per year. Developing countries show a yearly growth rate of 9.99% of their exports and an import growth of 10.28%. These numbers clearly show that developing countries have not been closed for goods from industrialized countries.[42]

While this indicates a balanced relationship, the theory of international trade does not unequivocally predict welfare improvements for all countries participating in it. This follows from the fact that more than one 'big theory' is needed to understand international trade and at least one more important theory beyond Heckscher-Ohlin has to be included which entails the insight that opening up does not, in all instances, lead to welfare maximization. Trade may contribute to growth if countries with different factor intensities and price levels engage in trade.[43] But in parallel, an exchange of similar manufactured goods is taking place, called intra-industry trade. In many cases this leads to welfare improvements as well, because a certain percentage of this exchange is driven by the variety of consumer tastes. Yet, this exchange implies 'head-to-head' competition too, which means that industrial sectors could be destroyed by their competitors and that unemployment and poverty may increase in the aftermath.[44] The following arguments are based on this assumption:

(1) Firstly, this insight that there is 'head-to-head' competition on the world markets must be taken seriously, as far as the least developed countries (LDCs) or African countries are concerned. Almost certainly, they have industries with production costs higher than world market price levels.

(2) Secondly, particularly highly populated countries like India, Indonesia, the Philippines, Pakistan, Nigeria, and Ethiopia, urgently need economic growth due to industrialization, which helps to increase both productivity and welfare. The decisive questions are, to what degree this growth should take place sheltered from world market competition and to what extent world market integration can help to spur this growth. What makes these questions even more interesting is that both of these growth effects together may be needed to increase world welfare in an optimum manner and to reduce poverty more effectively. In addition, this 'combined scenario' implies that both worlds, industrialized and developing, would benefit more by giving in to this 'combined scenario' in contrast to a situation of free trade, which relies solely on the external side of integration. For instance, India is a developing country in many respects but also possesses a capital goods sector which is able to create internal growth dynamics although it will take time to make it fit for world market competition.[45]

With regard to these countries (and the LDCs), the central focus should therefore not be on the question of how to liberalize but how to restructure existing industries and how to build up and strengthen their technological capabilities in order to increase welfare in the best possible way, in

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[42] Growth rates of merchandise exports and imports. UNCTAD Handbook of Statistics On-line. In: http://www.unctad.org.

[43] That this is true in certain cases can be shown at the example of Indonesia's land owners and rural workers who would, together with Japanese consumers, clearly benefit from a full liberalization of Japan´s agricultural markets because very high prices are charged there. Here it is all too obvious that many groups can gain much from opening up. Vanzetti et al. 2005, p. 22.

[44] Markusen, James R., Melvin, James R., Kaempfer, William H., Maskus, Keith E. International Trade. Theory and Evidence. New York: McGraw Hill, 1995. p. 190.

[45] Lall, Sanjaya. Learning to Industrialize. The Aquisition of Technological Capability by India. London: MacMillan, 1987. S. 226-229. (fortan Lall 1987)

short: development.[46] Liberalization can certainly play a role in this development process but the question remains as to how liberalization can be put to the best possible use and whether free trade should be the ultimate aim.

Liberals, for example, use the domestic resource cost (DRC) concept in order to evaluate whether industries are worth surviving. This is a static concept which warns firms not to use too much imports in production and not to pay high industrial wages because – taking world market prices as a yardstick – this uses too much domestic resources. Essentially, this concept implies that more foreign exchange could be earned if these domestic resources were used in different sectors of the economy, for instance in labour-intensive production. It is argued that industries which do not stand this test should better give up, in order to let domestic capital concentrate on firms with comparative advantages.[47] Surely, this concept makes sense to a certain degree.[48]

Nevertheless, its logic can be pushed too far. For example, its supporters conclude that Kenya's farmers should avoid crops with costly input use. Instead, they should use more labour and land (tell this to a smallholder in Africa with less than 2.5 acres of land).[49] Or often in African metal processing, DRC values higher than unity are found (between 2.45 and 7.87 in Ghana[50] and 2.15 in Madagascar[51]). Does this imply that metal processing is, in general, bad for African economies and should not be nurtured to build up skills and to attract, for example, outsourcing assembly investment?[52] Should, for example, the Zambian copper wire producer Zamefa (privatized and bought by Phelps and Dogde) therefore close down?[53] In comparison, Thailand's DRC for automobiles is 5.18 because DRCs are inflated not only by expensive production inputs but also by tariffs on them.[54] Should foreign investors therefore be pushed out of Thailand's automobile sector because they engage in an activity which contravenes against the law of comparative advantage?

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[46] It is common that the state is engaged in restructuring of its industries and that this can lead to technological upgrading. Nonetheless, the discussion about this important issue is often not related to the question of liberalization. See: Pomerleano, Michael, Shaw, William. World Bank. Corporate Restructuring. Lessons of Experience. Washington, D.C., World Bank, 2005.

[47] It is difficult to say which comparative advantages countries have and how the intensity of these advantages can be estimated. It is necessary to know this in order to calculate social opportunity costs (i.e. to say in which sectors it is best to invest from a welfare perspective). Although it is admitted that this is difficult, it is concluded that it is not impossible and that "intelligent guesses" could be used, which leaves wide discretion to the authors who apply these concepts. See: Bruno, Michael. Domestic Resource Costs and Effective Protection: Clarification and Synthesis. In: Journal of Political Economy, Vol. 80 No. 1, 1972. p. 31, Footnote 36. See how the concept is used, which is leading to policy recommendations: Greenaway, David, Milner, Chris. Industrial incentives, domestic resource costs and resource allocation in Madagascar. In: Applied Economics, Vol. 22, 1990. pp. 816-818. (fortan Greenaway/Milner 1990)

[48] For example, when massive restrictions of imports and foreign exchange put premia on imports but still these items could be sold for high prices in internal markets. See for example: Umbadda, Siddiq. Domestic Resource Costs for Sudanese Manufacturing Industry: A preliminary analysis. In: Development and Change, Vol. 16, 1985. pp. 153-154.

[49] Masters, William A. Policy Measurement for Trade Negotiations and Domestic Reforms. Revised 2003. In: http://www.agecon.purdue.edu/staff/masters/WillMaster-PolicyMeasurement.pdf.

[50] Biggs, Tyler, Shah, Manju. Trade Reforms, Incentives on the Ground and Firm Performance in Ghana. RPED Paper No. 105, July 1997. In: http://www.worldbank.org/rped/documents/rped105.pdf. p. 19.

[51] Greenaway/Milner 1990: 817.

[52] This may be the implication of the conclusion by Greenaway/Milner: "This implies there may be a considerable resource misallocation associated with commercial and industrial policy. It also suggests that greater allocative efficiency could be achieved by encouraging resources to shift from activities with relatively high DRCs to activities with relatively low DRCs." Greenaway/Milner 1990, p. 818.

[53] Zamefa dominates engineering exports with a yearly sum of over US$ 25 million, it produces copper wires, telephones cables, etc. See: http://www.zambiz.co.zm/assoc/exportboard.htm; and: http://www.pdwireandcable.com/WorldwideLocations/Africa_Zambia_Luanshy.htm. More details in point 5 below.

[54] See Box 2 in: Mingsarn Kaosaard, Mingsarn. Economic Development and Institutional Failures in Thailand. TDRI Quarterly Review, Vol. 13 No. 1, March 1998. See: http://thaieconwatch.com/articles/m98_1/m98_1.htm.

Thus, as far as I can see, the domestic resource costs argument is not fully convincing. One may argue that industries make a worthwile contribution to welfare if they do not charge high prices on domestic markets, show moderate productivity increases, enhance the quality of the domestic industrial structure and do not hinder the growth of export-oriented industries, even if they import some production inputs. Of course, export orientation may benefit from resources freed in other sectors, for example, capital formerly used in industry.[55] Nevertheless, perhaps a compromise level could be found because in many countries there is some foreign exchange available to finance production inputs, even if export-oriented industries are given priority to import inputs.

Neoclassical economists do not accept these arguments, dogmatically claiming that optimal welfare can only be reached by free trade and concentration on comparative advantages, without giving due regard to the fact that deindustrialization may be the consequence.

5. Ignoring empirical insights

The neoclassical school and negotiators from the United States and the European Union disregard the literature on effects of liberalization.[56] This attitude is made easier because, admittedly, it is often difficult to distinguish between the effects of tariff cuts, macroeconomic aspects of structural adjustment, policies which reduce staff levels in public administrations and, finally, those policies which aim at privatizing state enterprises.[57] Furthermore, attention must be given to the change of incentives by an export-oriented policy because in quite a few cases, this has led to an expansion of certain sectors. Liberals use this fact to put forward the thesis that negative effects on employment and growth are only short-term effects, while there are long-term positive effects.[58]

Be that as it may, empirical studies show problematic effects of liberalization on the manufacturing industry in small countries, concerning the many state enterprises which still exist in developing countries, and furthermore, that high import growth rates, mass unemployment and decreasing wages are rightfully considered among the negative effects of liberalization.[59] Therefore, although there are

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[55] Liberal theoreticians often seem to dream of fully flexible economies in which the real sector helps to solve macroeconomic and exchange rate problems. For example, it is assumed that the contraction of import competing sectors leads to lower demand and lower prices, which in turn help export-oriented sectors to expand production, while due to these falling prices, i.e. domestic resource costs, export expansion can take place without an appreciation of currency. DR-CAFTA. Challenges and Opportunities for Central America. Central America Department. Washington: World Bank, 2005. p. 69. In: http://www.worldbank.org.

[56] Schilder, Klaus. Lessons Learned. The Impact of Trade Liberalization Policies on Countries and Regions in the South - A Collection of Evidence. Bonn: Weed, 2002. In: http://www.weed-online.org. p. 7, 39-42.

[57] Sahn, David E., Dorosh, Paul A., Younger, Stephen D. Structural Adjustment Reconsidered. Economic Policy and Poverty in Africa. Cambridge: Cambridge University Press, 1997. pp. 58-59, 152-159. (quoted as Sahn et al. 1997)

[58] Hoeckman, Bernard, Michalopoulos, Constantine, Schiff, Maurice, Tarr, David. Trade Policy. In: Klugman, Jeni (Hrg.). A Sourcebook for Poverty Reduction Strategies. Vol. 2: Macroeconomic and Sectoral Approaches. World Bank: Washington, 2002. p. 30, 32. The following article is often mentioned to support this thesis. It also claims that openness does not lead to unemployment. Nevertheless, this article describes many episodes which show that liberalization has causal connections with job losses. Rama, Martin. Globalization and Workers in Developing Countries. World Bank Policy Research Working Paper No. 2958, January 2003. In: http://www.worldbank.org.p. 19. (quoted as Rama 2003)

[59] See Rama 2003: 17-33 for the previous two points.

positive effects of export orientation and liberalization, it makes sense to look for policy alternatives to protect the poor countries against these negative effects, perhaps even with tariffs.

Some liberalization experiences can be summed up: in Zimbabwe, an expansion of certain sectors, for example furniture and dairy products, can be observed, on the other hand there is a general stagnation in the textile and clothing sector. All in all, manufacturing output decreased by 20% (1990–1999).[60] Simbabwe is regarded as an example for a country which comprises of abundant land resources, nevertheless, it produces many manufactured products (32 % of exports in the year 1990).[61] In Sierra Leone, Zambia, Uganda, Tanzania, and Sudan, liberalization led to an increase in imports of consumer goods, therefore making less foreign exchange available for the import of production inputs.[62] In Tanzania, liberalization and subsidy cuts after 1986 led to a contraction of 43% and 20% in certain industries, in others output increased by 24%.[63] In Mexico, tariff reductions of 15% caused a 5% decline in wages.[64] The Equador example similarly shows that imports of consumer goods quickly increase after liberalization, from US$ 229 million (1990) to US$ 1.3 billion. Difficulties for local firms were reported, while agricultural goods exports expanded rapidly.[65] In Ghana, liberalization was extended to consumer goods between 1987 and 1993, and manufacturing employment declined from 78,700 to 28,000.[66]

During the more liberal 1990s, the manufacturing sector of Zambia grew. On the one hand, this was caused by an expansion of sectors with a comparative advantage, textiles and processed agricultural products, on the other hand the contribution of metal and engineering products to exports (which is still substantial) declined. The copper wire producer Zamefa, see above, will survive and even expand exports, but smaller firms (Galco, Zamula) which, for example, produced sheet metal, closed down because of an increase in competition from China, Russia and South Africa.[67] Including reforms of the public administration, there was, all in all, a massive increase in unemployment in Zambia. Employment in the formal sector declined from 23.3% (1980) to 8.1% (2003). [68]

In Bangladesh, the share of the manufacturing sector in GDP and its productivity increased after liberalization. Nevertheless, this occurred parallel to an absolute decline in manufacturing

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[60] Tekere, Moses. Trade Liberalization under Structural Economic Adjustment - Impact on Social Welfare in Zimbabwe, April 2001. In: http://www.saprin.org. p. 11, 22-24.

[61] Wood, Adrian, Jordan, Kate. Why does Zimbabwe Export Manufactures and Uganda Not? Econometrics meets history. In: Journal of Development Studies, Vol. 37 No.2, December 2000. S. 107.

[62] Buffie 2001: 191.

[63] Sahn et al. 1997: 58-59.

[64] Rama, Martin. Globalization and Workers in Developing Countries. World Bank Policy Research Working Paper No. 2958, January 2003. In: http://www.worldbank.org. p13. (quoted as Rama 2003)

[65] SAPRIN Equador. The Social and Economic Impacts of Structural Adjustment Policies in Equador 1982-1999. January 2001. In: http://www.saprin.org. p. 4.

[66] Buffie 2001: 191.

[67] Zambia. Diagnostic Trade Integration Study, June 2005. In: http://www.integratedframework.org. pp. 63-64.

[68] UNCTAD. Trade Reform and Adjustment: The Zambian Experiences, 1980-2003. United National Conference on Trade and Development. Trade Analysis Branch. Non-Agricultural Market Access (NAMA) Negotiations. Adjusting to Trade Reforms: What are the Major Challenges for Developing Countries? 18-19 January 2005 Geneva, Switzerland. In: http://192.91.247.38/tab/namameeting/nama.asp#NAMADocs. pp. 23-25.

employment. Imports increased from 1990 to 2000 from 16.7% to 23.0% of domestic demand. If a quantitative restriction on salt were to be abolished, 40,000 workers would be affected.[69]

Some more details can be presented on Ethiopia, whose liberalization took place after 1992. The unweighted average tariff went down from 28.9% in 1995 to 17.5% in 2002.[70] Its manufacturing sector is very small, 6.5% of GDP, but grew by 10.2% per year from 1993 to 2001.[71] The manufacturing sector concentrates, in the field of construction materials, on the production of cement, bricks, hollow block and steel reinforcement bars; regarding the transport sector, there is a truck assembly plant; tyres and tubes and a few components are produced, furthermore there is metal processing like metal sheets, and some chemicals and plastics production. The manufacturing sector seems to be dominated by 150 state-owned companies.[72] The most important goods in this sector are consumer goods like food, beverages, clothing and textiles, which account for 60% of manufacturing employment.[73] Heavy industry has a 20% share.[74] The textile sector consists of 14 state-owned and private enterprises which produce cotton and nylon fabrics, acrylic threads, wollen and waste cotton blankets and sewing thread. It employs 30,000 people.[75] All in all, there is a considerable presence of state-owned companies. The number of workers employed in public-sector manufacturing increased from 78,000 in 1978 to 250,000 in 1999.[76] Liberalization had both positive and negative effects. Positive is that imported inputs and investment goods were better available and that this contributed to the high growth and renewed investments in manufacturing. Furthermore it is claimed, however, that only sectors where private firms participated showed a positive total factor productivity growth.[77] Be that as it may, the data shows that capital investments in state-owned enterprises clearly had positive effects on labour productivity and perhaps even on total factor productivity growth. In specialist literature, this is regarded as negative. Instead, labour-intensive firms should be built up in Ethiopia.[78] It is interesting that, contrary to liberal expectations, the labour-intensive sector did not expand. The state-owned sector producing textiles and clothing, leather products and shoes exhibited low productivity growth. Especially state-owned textile firms sharply contracted due to liberalization, without any increase in export orientation.[79] What makes things worse is that the private sector in Ethiopia is incapable of an export response in the labour-intensive sector. It consists of weak firms and

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[69] UNCTAD. Policy Reforms and Trade Liberalization in Bangladesh. United National Conference on Trade and Development. Trade Analysis Branch. Non-Agricultural Market Access (NAMA) Negotiations. Adjusting to Trade Reforms: What are the Major Challenges for Developing Countries? 18-19 January 2005 Geneva, Switzerland. In: http://192.91.247.38/tab/namameeting/nama.asp#NAMADocs.p S. 16.

[70] Ethiopia. Trade and Integration. Vol. 1. Summary and Recommendations. Diagnostic Trade Integration Study. July 2004, final version. In: http://www.integratedframework.org. p. 20.

[71] Ethiopia. Trade and Integration. Vol. 2. Synthesis. Diagnostic Trade Integration Study. July 2004, final version. In: http://www.integratedframework.org. p. 88. (quoted as Integrated Framework Ethiopia 2004)

[72] See: Country Commercial Guide - Ethiopia. Fiscal Year 2001. Prepared by the US Embassy Addis Ababa, July 1, 2000. In: http://www.telecom.net.et/~usemb-et/wwwhec11.htm. p. 19. Concerning more details on the industries mentioned here, see: Industrial Policy Paper, Government of Ethiopia 1995, Addis Ababa. In: http://www.sas.upenn.edu/African_Studies/eue_web/indust2.htm.

[73] See: Industrial Policy Paper, Government of Ethiopia 1995, Addis Ababa. In: http://www.sas.upenn.edu/African_Studies/eue_web/indust2.htm.

[74] Integrated Framework Ethiopia 2004: p. 94.

[75] See: Embassy of Ethiopa, Washington D.C.. In: http://www.ethiopianemabssy.org/expimp.shtml.

[76] See: Integrated Framework Ethiopia 2004: 89; and Country Commercial Guide - Ethiopia. Fiscal Year 2001. Prepared by the US Embassy Addis Ababa, 1 July 2000. In: http://www.telecom.net.et/~usemb-et/wwwhec11.htm. p. 19. According to other figures, employment in organized manufacturing grew from some 82,600 workers in 1991/92 to around 93,500 in 2000/01. Integrated Framework Ethiopia 2004: 89.

[77] Integrated Framework Ethiopia 2004: 91.

[78] Integrated Framework Ethiopia 2004: 91.

[79] Integrated Framework Ethiopia 2004: 89.

has not actively reacted to the new opportunities.[80] On the contrary, domestic market-oriented leather, garment and shoe firms scaled down their operations or closed because of import competition.[81] For instance, 20 shoe factories allegedly had to be closed down and 15,000 workers had to be laid off due to Chinese competition.[82] There is, however, one positive development: low-quality garments and grey cloth production expanded, but account for only 0.5% of exports.[83] In conclusion, although in Ethiopia the problem of importation of production inputs to support the capital-intensive industry is clearly discernible (50% must be imported[84]) and, in general, it is difficult to build up an intermediate goods industry to change this, it does not seem to be completely wrong to preserve some of the capital-intensive industries and to delay privatization of some state enterprises. This is true, even if there is some success of labour-intensive production compatible with comparative advantages: Ethiopia's flower industry (recently migrated from Kenya) earns US$ 20 million in exports and employs 13,000 farmers.[85] Ethiopian exports are at US$ 601 million, imports at US$ 2,587 million (2004).[86]

Vietnam is another example of countries where liberalization results in direct pressure on state enterprises. For Vietnam, an estimated 50% of state enterprise jobs would be redundant under liberal conditions; this would affect 5,740 firms with 1.7 million employees (15% of total non-agricultural employment in Vietnam). These figures show that it might be wiser to delay this transition process a short while in order to restructure or even try to preserve some of these structures.[87]

In Nepal, liberalization did lead to an expansion of labor-intensive manufacturing, carpets and clothing, and the situation of the domestic industry improved because imports of production inputs became easier. Productivity increased, but not in the field of labour-intensive manufacturing. The still protected import substitution sectors managed to increase their productivity, i.e. textiles, radio/television, electro, metals, leather, beer, cigarettes, plastic products and soap.[88] In sum, there are export successes in line with comparative advantages but little export diversification and no productivity increases in export manufacturing so far in Nepal.[89]

Finally, authors writing for the IMF are worried that middlemen benefit from liberalization in Africa and spend their money on consumer goods while the genuine producers of the goods do not gain much and therefore the demand for locally produced goods does not increase. In other words: perhaps even

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[80] Integrated Framework Ethiopia 2004: 90.
[81] Integrated Framework Ethiopia 2004: 91.
[82] See: Ethiopia's industrial development is at the mercy of what globalization would bring about, says a leader of the manufacturing association. In: http://www.addistribune.com/Archives/2001/12/07-12-1/Ethiopia.htm.
[83] Integrated Framework Ethiopia 2004: 53, 93-95.
[84] Integrated Framework Ethiopia 2004: 94.
[85] See: Associated Press. Update 1. Kenyan Flower Farms move to Ethiopa. 09.01.2005. In: http://www.forbes.com/technology/ebusiness/feeds/ap/2005/09/01/ap2201237.html.
[86] World Bank. Ethiopia at a Glance. In: http://www.worldbank.org/data/countrydata/aag/eth_aag.pdf
[87] So far 90% of the 200 biggest state enterprises are operating profitably. Belser, Patrick, Rama, Martin. State ownership and labor redundancy - estimates based on enterprise-level data from Vietnam. Policy Research Working Paper 2599. Washington: World Bank, 2001. p. 5, 8, 28.
[88] Sharma, Kishor. Liberalization and Structural Change: Evidence from Nepalese Manufacturing. Economic Growth Centre, Yale University. Centre Discussion Paper No. 812. April 2000. In: //www.econ.yale.edu/growth_pdf/cdp812.pdf. p. 13, 15.
[89] These products are largely agricultural products: Niger seeds, sunflower seeds, lentils, large cardamoms, tomatoes, cut flowers, roses, carpet, leather, wet blue buff, wet blue goat, handicrafts, stone-carved buddha, citronella, lemon grass, mentha, tea (speciality). Nepal. Trade and Competitiveness Study, 22 Oct. 2003. In: www.integratedframework.org.

today, tariffs on luxury items makes sense in order to discourage the demand for imported consumer goods.[90]

Box 1: IMF is worrying about NAMA causing import surges.

The IMF is taking the problem of import surges very seriously and in response has established a so-called trade integration mechanism 'TIM', with the express aim to mitigate the balance of payment difficulties resulting from multilateral tariff lowering by providing additional lending. More specifically, the IMF is afraid that preference erosion and more intense competition in textile and clothing will lead to import surges in some countries.[91]

In sum, these empirical episodes suggest that the following arguments concerning the effects of liberalization must be further pursued:

(1) Firstly, it may not necessarily be 'economic', 'efficient' or 'welfare maximizing' from an economic policy view if the existence of many firms is threatened (refer to point 5.1 on Africa and point 5.3 on India).

(2) Secondly, there are countries where market failure is clearly visible, for example a shallow integration of the industry structure. In this case, it is not completely unrealistic to change this situation by following a clever industrial policy which may use tariffs (refer to point 5.2 on Indonesia).

(3) Thirdly, state enterprises still play an important role in certain countries, for example in Ethiopia, Vietnam and India (see below). This dimension of liberalization has been completely forgotten in the discussion, which is hard to understand considering the dramatic adjustment episodes in transition economies and the precarious years in China in the nineties.[92]

India is an example of both the role of state enterprises and the fact that careful restructuring is needed to preserve the assets of both state and private firms, while sheltering internal economic dynamism, under the conditions of globalization (see point 5.3).

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[90] Boccara, Bruno, Nsengiyumva, Fabien. Short-Term Supply Response to a Devaluation. World Bank Policy Research Working Paper, No. 1428, February 1995. In: http://www.worldbank.org. p. 24.

[91] "The negotiations have highlighted several implications of a Doha Round agreement that might result in temporary balance of payments shortfalls: the erosion of the margin of tariff preferences under preferential trading arrangements (PTAs) as most favoured-nation (MFN) tariffs decline; adverse changes in the terms of trade of net food importers as agricultural subsidies are cut; and more intense competitive pressures in the markets for textiles and clothing following the elimination of bilateral quotas in 2005 under the WTO Agreement on Textiles and Clothing (ATC). While the latter was agreed during the Uruguay Round, it has nevertheless raised concerns during the current negotiations, where it has been linked to the possible erosion of preferences for the same products." IMF 2004: 5.

[92] Rama 2003: 13, 23.

5.1 Africa's weak manufacturing industry

Some additional information on Africa will be presented. In Africa, there are many industries which, for various reasons, cannot compete on world markets. Still, those industries encompass an impressive breadth of activities and are therefore subject to world market competition. They cannot hide in the 'informal sector'. See the following examples (natural resource and processed agricultural goods sectors are excluded):

Many people work in the textile and clothing sector which suffers from quality and scale problems and is subject to increased competition from world markets due to liberalization. In smaller African countries, there are typically simple firms who produce articles for basic everyday use, metalworking firms, furniture producers, manufacturers of simple household items and perhaps agricultural handtools and often, there is a relatively diversified food industry (international firms are only selectively active here, similarly locals are engaged, for example in the production of edible oils or soft drinks, not to mention the delicious bakeries). Turning to more advanced countries and industries now, there is a more sophisticated metal producing and processing industry, which produces tubes, carts, wheelbarrows, ploughs, machetes, small hand-operated oil presses and water pumps, corrugated iron for roof covering and barbed wire. Some firms make aluminium pots and pans, others produce glass bottles. In some countries, there are bicycle assembly plants. Consumer goods like cosmetics, detergents and soup are made locally, and in certain countries, items for electrical systems, wires and fuse boxes are on the list. In addition, paint, cement, bricks, and steel reinforcement bars are provided to the building industry. Foreign-invested tyre and battery producers are active at certain places. Kenya owns a paper mill; in Tanzania, cooling radiators are made and there is a truck and tractor assembly; some countries produce chemicals and fertilizers or have managed to host aluminium smelters, notably Ghana and recently Mozamibque. The only integrated steel plant of Sub-Sahara Africa exists in Zimbabwe (South Africa is excluded). Agricultural machinery is produced here too. In Kenya, for example, scrap steel for an electric arc furnace oven has to be imported to make steel sheets and steel wires.[93]

Even if it does not make sense from the point of view of economic science to preserve all these industries – the Kenyan chemicals industry, for example, has to import most of its production input, and in Tanzania, radios, hairdryers and torches are assembled out of Japanese parts (see the discussion on DRCs above) – the question is whether a complete deindustrialization of Africa should be allowed and whether all these industries should be brought to the verge of collapse, for example due to imports of cheap goods from Asia?

[93] Information taken from diverse sources, among others from Trade Policy Reviews on African countries. One source is: Wangwe, Samuel M. Exporting Africa: Technology, Trade and Industrialization in Sub-Saharan Africa. London, New York: The United Nations University/Institute for New Technologies, 1995. In: http://www.unu.edu/unupress/unupbooks/uu34ee/uu34ee00.htm.

Four arguments are presented to provide tentative answers to this question:

(1) Although many of the activities above do not conform with expectations one might have about industries perfectly well suited to African factor endowments, the first thing which is striking is that they are closely related to basic needs. In addition, these industries are assets, seen from an economic point of view. It can be argued that 'asset' includes the experience of workers as well: training and knowledge about management questions is certainly valuable, especially under African circumstances where there is a grave undersupply of these capabilities.[94] Furthermore, at least some of these industries could be the basis for a future dynamic development:

"The first step in the liberalization argument is incontrovertible: activities exposed to liberalization that cannot compete will certainly die out. However, it is not clear whether activities that are presently uncompetitive are inherently uneconomic, hence not worth saving. This assumes that there are no learning processes, and that activities cannot be in the process of becoming efficient."[95]

These and similar arguments are used in a lot of publications about Africa[96] but this is not noticed within the discussion.

(2) The example of Africa also shows that liberalization alone is insufficient to increase firms' competitiveness. A large percentage of the firms choose to react to liberalization not with new investments and more intense technological effort:

Many firms choose a 'defensive' strategy in response to liberalization. They reduce staff, they start to focus on market niches, they lower production quality and try to compete with less intense technological effort ('low technology strategy').[97] A World Bank investigation of Parker et al. (1995) found out that 60% of firms employ a 'low technology strategy' when confronted with more liberal conditions.[98] In Tanzania, 50% of the firms react this way.[99] It is disturbing when more than half of the

[94] Insufficient supply of knowledge could be considered as market failure. UNIDO 2004: 36-38. Roughly similar is the argument of Rodrik (1992) who refers to the classical discussion of market failures. He argues that protection can provide incentives to counteract unecessary low investments into training or technology development, which occurs if there is a high fluctuation of workers or an insufficient protection of knowledge. In addition, it is argued that infrastructure investment may become profitable if industries using these structures achieve scale economies. Rodrik, Dani. Conceptual Issues in the Design of Trade Policy for Industrialization. In: World Development, Vol. 20 No. 3, 1992. pp. 309-320.

[95] Lall, Sanjaya. Opening Up – and Shutting Down? Synthesis, Policies and Conclusions. In: Lall, Sanjaya (Hrg.). The Technological Response to Import Liberalization in Sub-Saharan Africa. United Nations University, INTECH. London: MacMillan Press, 1999. p. 228. (quoted as Lall 1999)

[96] See: UNIDO. Industrialization, Environment and the Millennium Development Goals in Sub-Saharan Africa. Vienna: UNIDO, 2004. In: http://www.unido.org. p. 16; Lall 1995a: Lall, Sanjaya. Structural Adjustment and African Industry. In: World Development, Vol. 23, No. 12, 1995. p. 2026; Lall/Latsch 1998: Lall, Sanjaya, Latsch, Wolfram. Import Liberalization and Industrial Performance: The Conceptual Underpinnings. In: Development and Change, Vol. 29, 1998, p. 457-460; Morrissey, Oliver. Politics and Economic Policy Reform. Trade Liberalization in Sub-Saharan Africa. In: Journal of International Development, Vol. 7, No. 4, 1995. p. 606-607; for African protection in the face of increased competition from international markets in the field of textiles and clothing argues: Thoburn, John. Finding the Right Track for Industry in Africa - Some Policy Issues and Options. Discussion Paper. Vienna: UNIDO, 2000. In: http://www.unido.org. p. 14. (quoted as Thoburn 2000)

[97] UNCTAD. Fostering Technological Dynamism: Evaluation of Thought on Technological Development Processes and Competitiveness: A Review of the Literature. United Nations: New York and Geneva, 1996. p. 22.

[98] Parker, Ronald R., Riopelle, Randall, Steel, William F. Small Enterprises Adjusting to Liberalization in Five African Countries. World Bank Discussion Papers. Africa Technical Department Series No. 271. Washington: World Bank, 1995.

firms are not able to react to liberalization as liberal theory expects. Might it not be necessary to modify certain liberal assumptions in such a case, for instance, assumptions about trade policy? One thing is clear, it makes sense to help African countries to strengthen the capabilities of their enterprises:

"A recent study of technological capabilities in Ghana in the adjustment period concludes that the generally low level of capabilities have meant that rapid liberalization, unaccompanied by supply-side measures to develop skills, capabilities and technical support, has led to significant and costly deindustrialization."[100]

(3) Even if investments are made, it is obvious that most African firms command insufficient financial reserves. A microeconomic study about the manufacturing sector in Ghana documented that in 55% of all cases firms invest during the year, 45% are not able to make any investments. On average, investment lies at 14% of invested capital, this is a little more than what is needed to compensate for the usual capital depreciation rate of 13%. An investigation into 23 firms in Ghana showed that only 7 firms have invested more than US$ 100,000 since 1983 and only 2 have invested more than US$ 1 million.[101] Thus, African firms, operating on small domestic markets, command much lower levels of resources, compared to firms in certain other countries.

(4) Most African countries belong to the group of primary-goods-exporting least developed countries. With regard to the specific characteristics of these countries, Buffie (2001) calculated that, parallel to export orientation, a high tariff protection for consumer goods can be optimal to increase welfare because this leads to higher wages, employment and investments in an import-substituting consumer goods sector. In combination with export subsidies, an effective protection level of 52–72% is suggested. Without subsidies, the optimal effective tariff levels are found to be lower, from 20 to 30%. Tariffs on production inputs should be much lower in order not to interfere with export-oriented firms.[102]

To conclude these observations concerning Africa we can say that long-term tariff protection can be justified for certain sectors in the sense of 'passive protection'. The phrase 'passive protection' is used to stress that this does not imply an active development strategy. This kind of 'passive protection' can preserve assets and employment opportunities, but is is unclear for how long and if a positive development of productivity can be initiated. It is equally important to maintain export orientation, thus countries should not switch back to broad-based protection. Yet, it makes sense to protect certain consumer goods in whose production many poor people are engaged, like textiles, clothing, furniture, simple metal processing, etc. Finally, this implies that the import of most production inputs should not be hindered by tariffs.

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[99] Deranigala, Sonali, Semboja, Haji H.H. Trade Liberalization, Firm Performance and Technological Upgrading in Tanzania. In: Lall, Sanjaya (ed.). The Technological Response to Import Liberalization in Sub-Saharan Africa. London: MacMillan, 1999. pp. 129-130.
[100] Lall, Sanjaya. Structural Adjustment and African Industry. In: World Development, Vol. 23, No. 12, 1995. pp. 2019-2031, 2026.
[101] Lall, Sanjaya, Navaretti, Giorgio Barba, Teitel, Simón, Wignaraja, Ganeshan. Technology and Enterprise Development. Ghana under Structural Adjustment. New York: St. Martin's Press, 1994. p. 115.
[102] Buffie 2001: 161-184.

It is important to point out the difference between this approach and conventional liberal ones. Conventional approaches would never endorse 'passive protection' for reasons of economic theory. They would rightfully point out that this kind of 'passive protection' is not likely to increase firms' incentives to rapidly increase productivity. This is usually called rent-seeking.

Be this as it may, I certainly do not want to endorse rent-seeking in the sense of monopolistic exploitation of poor consumers. However, in many instances, there may be domestic competition among protected firms, especially in the sectors mentioned above, which will drive prices down and may even increase productivity continuously, but on a lower level. Still, a balancing of these forces remains necessary. Indeed, politicians must pressurize firms to invest; they must force them to restructure and to adopt modern technology and even take steps to enhance competition.

Admittedly, institutional resources for these kinds of policies are not equally distributed around the world. Nevertheless, there is one simple reason for preserving policy spaces. Rent-seeking and stagnation can be counteracted by policy measures or, for example, by better focused development aid. In contrast, the free trade scenario is devoid of any politics and implies that many industries and their related physical and human assets will disappear from Africa.

5.2 Indonesia's shallow integration as a market failure

Indonesia is a large country with a relatively large internal market. Still, its industrial structure is highly dependent on imported production inputs. This situation could perhaps be changed by improving the links between and the technological capabilities of firms. Indonesia's economy is growing but the value-added share of typical input-supplying industries like plastics, metal and cement is declining.[103] Industrial policy may help here. Admittedly institutions are weak[104] and may not fulfil conditions for industrial policy making set out by Rodrik (2004) who argues that policy makers must be able to keep their distance from the private sector to avoid rent-seeking while, at the same time, they need to closely interact with businessmen to obtain the right kind of information and to provide them with the right incentives.[105]

5.3 India seen from the experience of Argentina

There are some important differences between the situation in India and that in Africa. Despite tariff protection, it will be difficult for Africa to achieve a deeper integration of its manufacturing sectors. Growth must first rely on comparative advantages in the field of natural resources and agriculture. Success in other fields, like textiles and clothing, is not unlikely but some hard work must be done to achieve this. In parallel, it can save and upgrade parts of its industries and try, for example, to attract

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[103] Dhanani, Shafiq. Indonesia: Strategy for Manufacturing Competitiveness. Vol. II, Main Report. Jakarta: UNDP/UNIDO, November 2000. In: http://www.unido.org. p. 5, 7, 32, 34.

[104] See for the public debate on these questions in Indonesia: The Indonesian Public Policy Network (JAKAKI). Options for Indonesia's Industrial Policy. August 2004. In: http://www.unsfir.or.id/publications.php. p. 7, 15-16.

[105] Rodrik, Dani. Industrial Policy for the Twenty-First Century. September 2004. In: http://ksghome.harvard.edu/~drodrik/papers.html. p. 17.

assembly outsourcing. India and Indonesia have larger domestic markets which make it possible to rely, at least to a certain degree, on internal dynamics to support growth.

5.3.1 India

For two decades now India's economy has been growing continuously: from 1980–2000 the average growth rate was 3.8%, despite high protection. India is a very good example of the success of domestic reforms which induced a better business climate within the country. Rodrik/Subramanian (2004) persuasively claimed that 'pro-business' orientation mattered most and exports and liberalization played a secondary role.[106] Admittedly, there are more facets of India's policies. Labour-intensive exports have been encouraged by a favourable exchange rate.[107] The third aspect contributing to India's success is the liberalization policy since the beginning of the 1990s.[108]

In contrast to Africa, India built up a broad industrial structure during the period of import substitution which has significant technological capabilities. Still, this is often insufficient to compete on the world markets.[109] This applies to machine tools, capital goods and electronics. There are some exceptions to this rule: just as in many developing countries, certain producers have become efficient but many others are still too small and badly need to revamp their technology. This is true of the paper and aluminium industry.[110] Petrochemicals have already been exposed to international competition.[111] In steel, India has comparative advantages[112] and in the transport sector, restructuring has been advanced by a lot of joint ventures set up by western investors.[113] Nevertheless, these partial deviations do not change the overall picture. Export data makes India's weakness visible: it only has a 0.81% share of global trade in manufactured products (China 5%).[114] Exports mainly consist of labour-intensive products like jewellery, textiles and clothing while the share of chemicals and service exports is rising. In a different categorization, this can similarly be shown: resource- and labour-intensive 'low tech' exports dominate with 86%, 'medium tech' amounts to 13.1% and 'high tech' achieves a modest

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[106] Rodrik, Dani, Subramanian, Arvind. From Hindu Growth to Productivity Surge: The Mystery of the Indian Growth Transition, February 2004. In: http://ksghome.harvard.edu/~drodrik/papers.html. p. 1, 19-21. (quoted as Rodrik/Subramanian 2004)

[107] Starting with 1975 the value of the rupia was tied to a currency basket and, together with a restrictive monetary policy, this led to an exchange rate which supported exports. During the second oil crisis in 1979, there was a short period of inflation and appreciation of the exchange rate. Afterwards, in the eighties, a nominal und real depreciation took place: in 1980, the index number was 100; in 1992, the index number declined to 45. This contributed to an increase in Indian exports after 1985. Kapur, Devesh, Patel, Urjit R. Balance of Payments and Exchange Rate Policy in India. 15 May 2004. In: http://www.people.fas.harvard.edu/~dkapur/images/dk_balance.pdf. p. 3; Dean, Judith M., Desai, Seema, Riedel, James. Trade Policy Reform in Developing Countries since 1985. A Review of the Evidence. Washington: World Bank, 1994. p. 32.

[108] The relevance of the liberal reforms after 1990 is stressed in: UNCTAD. Trade Adjustment Study India. United National Conference on Trade and Development. Trade Analysis Branch. Non-Agricultural Market Access (NAMA) Negotiations. Adjusting to Trade Reforms: What are the Major Challenges for Developing Countries? 18-19 January 2005 Geneva, Switzerland. In: http://192.91.247.38/tab/namameeting/nama.asp#NAMADocs. p. 6. (quoted as UNCTAD India 2005)

[109] Lall 1987: 226-229.

[110] UNIDO. India. Towards Globalization. Industrial Development Review Series. Vienna: UNIDO, 1995. p. 14, 177-179. (quoted as UNIDO India 1995)

[111] UNIDO India 1995: 187.

[112] UNIDO India 1995: 174.

[113] UNIDO India 1995: 186-192; for a list of automobile joint ventures see Trade Policy Review India 1998: 148.

[114] Figures for 2004. Jha, Veena, Gupta, Sarika, Nedumpara, James, Karthikeyan, Kailas. Trade Liberalization and Poverty in India. Advanced/Unedited Draft. Geneva: United Nations Conference of Trade and Development, 2004. In: http://www.unctad.org. p. 24. (quoted as Jha et al. 2004)

4.4%.[115] One reason for this weakness is that India traditionally has had a very restrictive attitude towards foreign direct investment. In spite of recently improved openness and increased investment levels, the share of foreign direct investment in gross capital investments is considerably lower than in China (2004: 3.4% vs. 8.2%).[116]

Secondly, it is important to notice that, although India's economy has partly been kept going by the big investor families of the country, there is still massive public sector involvement and there are other important regulations. At the end of 1996, there were 234 firms which were operated by the central goverment and 1,036 enterprises belonged to regional governments (of which 507 were loss-making[117]). These firms are, for example, airlines, oil and telecommunication enterprises, machine tool and transport equipment producers and two integrated steelworks. The public sector is responsible for an estimated 1/3 of value added.[118] Although the state has been privatizing some of these firms and has been divesting itself of shares in others[119], this process is advancing slowly.

However, it is not just the presence of state enterprises that makes fast structural change more difficult. In India, 799 consumer goods are reserved for the small-scale enterprises which cannot compete due to scale disadvantages.[120] Examples are textiles, leather, furniture, paper, beverages, pharmaceuticals, certain metal products, certain plastic products (PVC pipes), quartz clocks and certain rubber products (shoe parts).[121] An investigation into the problems of small-scale industries with liberalization shows that, for example, Chinese goods have considerable cost advantages. Watch movements (the basic machinery of the watch) are being smuggled over the Himalayas from China, which have led to factory closures. Small manufacturers of plastic bags are threatened by imports because these are cheaper due to scale and energy cost advantages and because, in India, cost levels for polymer production inputs are higher. Toys are reserved for small-scale industries which, of course, cannot compete with Asian producers.[122]

In general, adaption processes are made more difficult because India suffers from high cost levels for sea transport, capital and energy (many firms are forced to operate their own power generators); this substantially affects competitiveness.[123]

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[115] Data for 1996. Further differentiation of 'low tech' is possible: 'resource based' 31.1%, 'labour-intensive' 52.3%. Lall 1999: 1776. See the definitions in: Lall, Sanjaya. The Technological Structure and Performance of Developing Country Manufactured Exports, 1985-98. In: Oxford Development Studies, Vol. 28, No. 3, 2000. (quoted as Lall 2000)

[116] In China, there is a foreign investment stock of US$ 245,467 billion, in India of US$ 38,676 billion (2004). This is a strong increase for India. In 1990, foreign investment stock lay at US$ 1,657 billion. Data: World Investment Report 2005, Country Fact Sheet India. In: http://www.unctad.org.

[117] Department of Disinvestment, Ministry of Finance. India. In: http://www.divest.nic.in/slpes_pos.htm.

[118] Trade Policy Review India 1998, Report of the Secretariat, WT/TPR/S/333. p. 98, 143. (quoted as Trade Policy Review India 1998)

[119] With more firm details. Department of Disinvestment, Ministry of Finance. India. In: http://www.divest.nic.in/index.htm.

[120] An enumeration of sectors in which goods are reserved for small-scale industries can be found in Trade Policy Review India 2000. p. 66.

[121] For this information, see the website of: http://www.smeindia.com/ssivariousstates.asp.

[122] Krishna, Sridhar. The Impact of Phasing Out of Import Licensing on Small Scale Industries. Indian Council for Research on International Economic Relations, Working Paper 60, December 2000. In: http://www.icrier.res.in/. p. 3-19. (quoted as Krishna 2000)

[123] Krishna 2000: 19. Cf.: Goswami, Omkar, Arun, A.K., Gantakolla, Srivastava, More, Vishal, Mookherjee, Arindam, Dollar, David, Mengistae Taye, Hallward-Driemier, Mary, Iarossi, Giuseppe. Competitiveness of Indian Manufacturing. Results of a Firm-Level Survey. Confederation of Indian Industry/World Bank, January 2002. In: http://www.worldbank.org. Thus, cost of electricity is at $ 0.07 kWh, in the USA at $ 0.04 kWh. p. 12, 16.

Liberalization in India has so far led to average applied tariffs of 29%.[124] During the Uruguay Round, 69.8% of tariffs were bound. Most consumer goods are still unbound but for certain finished and intermediate goods tariffs were bound at 40%, and for production inputs, machinery and equipment, tariff levels were bound at 20%. Moreover, in the field of computer and telecommunications equipment, zero levels were accepted on 217 tariff positions.[125] So far the result is that imports in relation to domestic production in the manufacturing sector lie at 13% while 51% of the firms are subject to import competition at a level of at least 10% (both figures in relation to manufacturing output).[126]

Studies on the effects of liberalization in India also show that differences between firms have been enhanced. Firms with relatively high productivity are influenced in a positive manner but many firms with lower technological capabilities and those situated in less advantageous regions unambigously belong to the loser category.[127] Moreover, it is expected that further liberalization will cause higher imports, especially in the consumer and capital goods sectors.[128]

Box 2: Model simulation forecasts for India

The above-mentioned worries are mirrored in model simulations which, in a 'hard' liberalization scenario, predict an increase of imports by 20.9% and in a free trade scenario, a 29.9% boost. In absolute numbers, imports of US$ 50.5 billion (2000/2001), which are already higher than exports of US$ 44.5 billion, would expand by US$ 10 billion or even US$ 15 billion. Although an increase in exports is calculated too, this expansion lies on a lower level than for imports: 20.5% and 14.9%. For the automobile sector on the one hand and the chemicals, rubber and plastics sector on the other hand, a free trade output minus of -6 and -2% is anticipated (in the 'hard liberalization' scenario -7 and -1%). If these simulations became a reality, India would increase its specialization towards textile, clothing, leather, jewellery, (and software) and its industrialization process in other sectors would be weakened. These output contractions would not occur under the less intense 'soft' liberalization scenario.[129] In general, a decline of industry in Indian value added does not seem to be desirable since the manufacturing sector has the moderate share of 17% of gross domestic product (China: 25%).[130]

Therefore, liberalization in India should be advanced with care. On the one hand, selective liberalization can improve efficiency in certain industrial sectors, on the other hand, there is the risk of damaging the good investment climate which has been created by the reforms so far.[131] Indian growth

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[124] Data for 2002. Goldar 2004: 1.

[125] Trade Policy Review India, Report of the Secretariat, WT/TPR/S/33, 5 March 1998. p. 53. Cf.: WTO Document TN/MA/S/4/Rev.1/Corr.1.

[126] Pandey, Mihir. Impact of Trade Liberalization in Manufacturing Industry in India in the 1980s and 1990s. ICRIER Working Paper No. 140. August 2004. In: http://www.icrier.org. p. 33, 39. (quoted as Pandey 2004)

[127] Aghion et al. 2003: 22-24.

[128] Goldar, Arvind Virmani Bishwanath, Veeramani, Choorikkad, Bhatt, Vipul. Impact of Tariff Reforms on Indian Industry: Assessment Based on a Multi-Sector Econometric Model. Indian Council for Research on International Economic Relations, Working Paper 135, June 2004. In: http://www.icrier.res.in/. p. 1, 33. (quoted as Goldar et al. 2004)

[129] de Córdoba et al. 2004: 25, 27; Trade Policy Review India 2002: 146-147.

[130] Trade Adjustment Study India. United National Conference on Trade and Development. Trade Analysis Branch. Non-Agricultural Market Access (NAMA) Negotiations. Adjusting to Trade Reforms: What are the Major Challenges for Developing Countries? 18-19 January 2005 Geneva, Switzerland. In: http://192.91.247.38/tab/namameeting/nama.asp#NAMADocs. p. 56.

[131] Rodrik/Subramanian 2004: 19-21.

was made possible by the expansion of the consumer and the capital goods sectors and 41% of output already belong in the category of scale-intense production.[132] Unfortunately, these are the sectors in which import increases are expected. It is true that India has the chance to counter this threat by restructuring and modernization. This was successfully carried out in the automobile sector with the help of foreign investments (while maintaining tariff protection).[133] Yet, in other sectors this process may be much more difficult.

All in all, a selective and gradual process of liberalization can be justified for India, especially if weak sectors are carefully restructured and technology is upgraded, perhaps with some help of the government. It is not unlikely that this may stir a more continuous process of economic growth which may help to reduce poverty in a more broad based manner, compared to a free trade situation. Box 3 gives some support for this argument:

Box 3: Poor households suffer from liberalization in the automobile sector and tariff protection helps A general equilibrium model focusing on income effects of liberalization on the level of households in Turkey shows that the urban poor would be negatively affected by free trade in automobiles. A tariff can help to avoid this. In a scenario in which the current high level of taxation for automobiles is preserved, the tariff protection scenario clearly enhances welfare of urban and rural households. Only if the high automobile tax is regarded as distortion which should be abolished and with the additional condition that there are not tax increases to compensate for revenue losses due to liberalization, free trade can be shown to be superior (still the poorest segment of the urban population loses 27% of its income). This leads to the interesting observation: "Tariff and export subsidies on vehicles serve to induce additional resources into vehicle production, which up to a point is efficient and welfare increasing from a second-best perspective."[134]

In addition, a selective liberalization may have certain advantages if one compares it to a quick takeover of an economy by foreign investment which may lead to a 'lock in'. This can be exemplified by Argentina:

5.3.2 Argentina

Argentina is a good example to show the relevance of the phenomenon of deindustrialization and restructuring in the presence of liberalization and foreign direct investment. Argentina has higher technological capabilities than Africa but a study on the effects of liberalization shows that 400 out of 25,000 firms in the manufacturing sector opted for an 'offensive restructuring' strategy in order to adapt to the changing fortunes between 1975 and 1995. These offensive firms represented 40% of GDP. 20 to 25 of these firms managed to survive. They produce basic inputs, iron and steel, petrochemicals, cement and aluminium. These firms are now operating on an international level with

[132] Pandey 2004: 31-33.
[133] Trade Policy Review India 1998: 146-149.
[134] Harrison, Glenn W., Rutherford, Thomas F., Tarr, David G. Trade liberalization, poverty and efficient equity. In: Journal of Development Economics, Vol. 71, 2003. pp. 124-125.

world standard technology.[135] Other firms are somewhat below the international standard, e.g. suppliers for the automobile industry (automobile assembly is unsuccessful), the oilseeds industry, milk products, telephone equipment and other industrial products.[136]

The remaining firms have only invested in short periods of economic booms, they operate at 5 to 10% of optimal scale and have preserved the workshop flair of the period of import substitution. These firms are responsible for 60% of GDP[137] and have been reacting to liberalization in a 'defensive' manner. Although they managed to increase productivity by 100%, this was not sufficient to achieve competitiveness. Mass unemployment was the result in Argentina.[138] In this period of time, pharmaceuticals, telecommuncation, electronic and capital goods were contracted.[139]

At the moment, tariff protection is on average 13.5% (1998); the bound tariffs were fixed at a level of 35% during the Uruguay Round. Argentina is still protecting special sectors, e.g. shoe production (30%) and automobile assembly (33%). But these are the highest tariffs ad valorem in manufacturing.[140] Nevertheless, liberalization can still have detrimental consequences for the Argentinian manufacturing sector. In Latin America, the tariff lowering since 1990 has led to a general increase in unemployment and inequality.[141] In Argentina, employment grew in the nineties but unemployment numbers remained high at 14.3% (1999). In the eighties it was lower, only 4–5% and 7.3% in 1990.[142]

What is meant by foreign investment 'lock in'? Tariff reduction does not automatically imply openness for foreign investment, but if one opens up, the Argentinian example shows what may happen if foreign investors take over an economy. The question remains whether this is good for the development of a country.

Up until now, multinational corporations have obtained the biggest share in domestic investments and secured 49% of manufacturing items sales and 38% of exports. Foreign investment stock more than doubled between 1992 and 1997 and reached US$ 36 billion. 66 out of the 200 largest companies resulted from privatization. However, even the WTO's Trade Policy Review staff is concerned because this led to a boost in concentration:

"Structural reforms have led to increasing concentration in the Argentinian economy, particularly in the services sector. An increasing share of business is in the hands of fewer, larger firms and conglomerates; in 1995, the activities of the top 14 companies in hydrocarbons, telecoms, motor vehicles, supermarkets, foodstuffs, beverages, tobacco and the lottery contributed to about 9% of

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[135] Kosacoff, Bernando. Business Strategies under Stabilization and Trade Openness in the 1990s. Inter-American Development Bank, Andres Bello Auditorium, Washington D.C., September 18-19, 2000. In: http://www.iadb.org. pp. 6-7, 8. (quoted as Kosacoff 2000)

[136] Kosacoff 2000: 6-7.

[137] Kosacoff 2000: 7, 9, 26-27.

[138] Kosacoff 2000: 7. There is a hint to this study with the above interpretation in: Lall 1999: 247.

[139] Kosacoff 2000: 24.

[140] Trade Policy Review Argentina, Report of the Secretariat, October 1998, WT/TPR/S/472. pp. 41-46, 102. (quoted as Trade Policy Review Argentina 1998)

[141] Buffie 2001: 190.

[142] Pou, Pedro. Argentina's Structural Reforms of the 1990s. Finance and Development, March 2000, Volume 37, Number 1. In: http://www.imf.org.

GDP. Only two state firms appeared among the top 1,000 companies. The concentration process also expanded progressively to rural areas where traditional landowners were replaced by large diversified firms such as Benetton and Soros."[143]

Thus, first of all, a competition policy response is needed. Secondly, it is not argued here that foreign investment is generally bad for the Argentinian economy. An interesting aspect here is the effect of foreign investment on the industrial structure and the growth prospects of a country. Nobody can deny that liberalization plus privatization has a certain 'lock in' effect on an economy. For Argentina, it can be shown that foreign-invested firms decide to de-verticalize their procurement. They turn to international suppliers rather than to national firms for their production input needs. Thus national firms may lose markets and the economy's degree of integration starts to disentangle, perhaps with negative consequences for the overall industrial structure.[144] My impression is that welfare in India will increase if this situation can be avoided.

6. Environment

Liberalization does not necessarily lead to a protection of the environment and a conservation of natural resources. Notwithstanding, NAMA negotiations are encompassing the forestry and fishery sector plus minerals and other resources.[145] The business community would interpret a success of tariff cuts in these sectors as a clear sign that exploitation of natural resources has been fully handed over to private enterprises, which should venture even more vigorously into exploiting forest and fishery resources in developing countries. This would certainly take place although it is well known that forests are dwindling and oceans are being overfished and a further commercialization of fishing would endanger survival, nutrition and the livelihood of millions of small fishers around the world. Furthermore, experts in environmental regulation acknowledge that markets will not bring about a sustainable management of natural resources. Although environmental protection measures can sometimes rely on market mechanisms which indirectly change incentives faced by consumers and firms, in many cases direct prohibitions are still in use. It is generally accepted that prices neither mirror ecological scarcities nor reflect environmental protection costs, nor prevent irreversible losses.[146] In principle, it is therefore acceptable to interfere with international trade to reach environmental and resource protection goals, as is shown by the various international environmental agreements. CITES prohibits trade with endangered species, the Basle Convention on Trade with Hazardous Wastes and the Montreal Protocol on Substances that Deplete the Ozone Layer both contain trade prohibitions. Though it is clearly preferable to negotiate international agreements to solve environmental problems, there may still be instances where unilateral measures can be justified. For example, export prohibitions and export taxes are criticized because these could lead to low price

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[143] Trade Policy Review Argentina 1998: 97.

[144] Kosacoff 2000: 28.

[145] Partially negotiations take place on a sectoral level. For example, New Zealand has been inviting countries to negotiations on liberalization in forest and fish products. In addition, eco labels are questioned and are regarded as non-tariff trade barriers. Knirsch, Jürgen, Mittler, Daniel. Verbesserter Marktzugang auf Kosten der Umwelt: Die Umweltrisiken der NAMA Verhandlungen, 2005. In: http://www.forumue.de/themenundags/handel/index.html.

[146] Bender, Bernd, Sparwasser, Reinhard, Engel, Rüdiger. Umweltrecht. Heidelberg: C.F. Müller, 1995. p. 37, 50-52 .

levels on domestic markets which will cause increased consumption. In such cases, direct prohibitions of production might be more effective. Still, there may be political reasons to use these measures.[147] In the NAMA negotiations, the EU demands the general prohibition of the use of export taxes and is thus paying no attention to this point.[148]

7. Conclusion: Globalization with policy spaces

Taking everything into account, it does not follow from economic policy considerations that full liberalization will be best for improving the world's welfare. Neither for industrialized countries which benefit in several ways from growth in developing countries, nor for the developing countries which may successfully use policy spaces they have at their disposal to maximize their own welfare.

Trade policy measures should remain available to preserve internal dynamism, to shelter assets of both state and private firms in situations of restructuring and to ensure the long-term protection of weak industries.

The alternative looks bleaker: few big firms stay internationally competitive, smaller firms close down and the biggest part of the economy is taken over by foreign direct investment. I do not oppose foreign investment but it seems to be important that, for example, India avoids 'lock in' situations which may be detrimental to its economic structure and its long-term development prospects because, for example, local suppliers would be delinked and the structure of the economy would be entirely shaped by foreign firms, like in Argentina.

Moreover, in weaker developing countries, for instance in Africa, it may make sense to apply long-term 'passive' protection for certain consumer goods and industrial sectors if this is not detrimental to growth and exports, otherwise the structure of the economy is solely defined by comparative advantages. It is neither encouraging nor sensible to see consultants all over the world advise weak countries to – only – specialize in rice, fish, tourism, agriculture, handicrafts and garments while smaller metal and plastic processing facilities are already being regarded as not being in line with comparative advantages.

Thus, NAMA negotiations should not endanger these policy spaces.[149] Developing countries in general should retain the right to dispose of these policy spaces and especially large developing countries like India (980 million inhabitants), Indonesia (240 million), the Philippines (75 million), Pakistan (132 million), Ethiopa (61 million) and Nigeria (121 million)[150] should be actively supported to use these spaces to enhance their economic performance for the global common good.

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[147] Kulessa, Margareta E. Umweltpolitik in einer offenen Volkswirtschaft. Baden-Baden: Nomos, 1995. p. 138, 208. UNEP Link to international environmental agreements: http://www.unep.ch/.

[148] Kohr, Martin. WTO Members Still far Apart on NAMA. TWN Info Service on WTO and Trade Issues, 25 September 2005. In: http://www.twnside.org.sg. p. 7.

[149] Chang, Ha-Joon. Policy Space in Historical Perspective - with special reference to Trade and Industrial Policies. Conference, Queen Elisabeth House, Oxford. 4-5 July 2005. In: http://www.networkideas.org/featart/Sep2005/Policy_space.pdf.

[150] Altogether 1.6 billion people. World Development Report 1999/2000: 230-231.

In sum, NAMA negotiations will lead to:

- the contraction of industrial sectors
- the loss of valuable assets, including knowledge and the experience of business people
- a focus on comparative advantages which is unwarranted because it does not mirror other options of countries to participate in international trade
- a loss of budget-supporting tariff revenue
- preference erosion which will make it more difficult for Africa to use textiles and clothing for industrialization; here even the IMF is worried
- pressures on balance of payments because imports will substantially increase
- less options to differentiate between necessary and unnecessary imports
- reduced policy spaces for industrial policy and for saving assets while restructuring
- pressure to restructure too quickly, including the pressure to let state enterprises contract, without offering alternative employment opportunities
- possibly a 'lock in' into a lower level growth path on world wide scale

In turn, forgetting about NAMA would:

- not decrease world welfare
- not question integration through international trade
- not discredit welfare improvements due to export orientation and selective liberalization

Consequently, at this point in time NAMA negotiations are unnecessary. The present level of liberalization is sufficient. Growth dynamics have been established in many countries around the world. The situation could even deteriorate by a rush towards more and binding liberalization which would possibly lead to a setback of trust in the 'liberalization cum policy spaces' process as such.[151]

For example, people in India are much less inclined to embrace globalization than Chinese people; some of their reasons have been explored in this text. Experts like Fred Bergsten are turning a blind eye to this and are convinced that the NGO protests in Seattle are the worst form of opposition against globalization. His answer to these protests is, of course, that liberalization must urgently be further pursued (his famous 'bicycle theory').[152] On the contrary: as it is argued here, a broader-based industrialization must remain the aim, especially for highly-populated developing countries, in order to avoid globalization setbacks. NAMA negotiations are opposed to this aim on many levels and are therefore, to make one further point, incompatible with the millennium goals of poverty reduction.

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[151] In India only 45% of people are convinced that globalization is good for their country. In China, this number is at 76%. UNCTAD India 2005: 5.

[152] Bergsten, Fred. The Backlash Against Globalization. Speech given before the Trilateral Commission, Tokyo, Japan, 9 May 2000. In: http://www.iie.com/publications/papers/paper.cfm?ResearchID=377.

Box 4: The question of fairness from the perspective of industrialized countries

Fairness should play a more important role in the discussion on NAMA. Large numbers of people in the industrialized countries are, openly or secretly, in favour of tariff cuts in developing countries because they are worried about the job situation in industrialized countries. Why should they then tolerate policy spaces in developing countries? Firstly, because we have signed a treaty with developing countries, the WTO treaty, which is quite advantageous for us and even leaves policy spaces to protect our own industries. This treaty, however, does not automatically guarantee free trade in the sense of a complete opening up of developing countries in the years to come. Secondly, industrialized countries have been in the position to shape their special risk management arrangement (see p. 5) and have therefore been protagonists for decades and, by means of their technological advancedness and ingenuity, have been main profiteers of international trade and the progressively intensified process of globalization. Though international firms have grown international recently, a large share of their value added still contributes directly to the welfare of industrialized countries. These firms, in addition, are successfully engaged in many sectors in the developing countries and, in many cases, have succeeded in imposing their oligopolistic market constellations on the market there. This is the case in Brazil, Argentina, Mexico, Thailand and Malaysia. Only a few countries managed to avoid this, like Taiwan and Korea before the Asian crisis. The only country which, at least to a certain degree, has the realistic chance to develop with the support of internal dynamics and domestically available capital is currently India. China has already been opened up to foreign investment and here the only question is how many world-class firms China can build up. Certainly not as many as the exaggerated discussions suggest. Thirdly, globalization proceeds essentially as 'combined scenario', where internal growth dynamism and stimulating external influences are combined due to liberalization, in order to achieve optimum growth (see p. 10). Thus, industrialized countries profit from the liberalization levels already achieved. Because of these characteristics of globalization it is, from the perspective of fairness, essential to keep policy space open. Accepting this becomes easier if one discovers that, in this case, moral principles and self-interests coincide because industrialized countries will benefit more from a continuous, dynamic growth process in developing countries than from free trade or a foreign investment 'lock in'.

For these reasons I can fully subscribe to the following statement of the Our World Is Not For Sale Network, which is supported by many NGOs:

"Halt the NAMA negotiations and agree to a full and independent review of NAMA's potential impacts on economic development, industrial diversification in developing countries, the environment and social welfare (including employment, health and gender balance);

Recognise and guarantee government's domestic policy space and flexibilities, preserving their right to use policy tools including trade measures, that develop fair and sustainable economies, protect and promote employment, social welfare, health and the environment and guarantee public participation.

Promote resource conservation and the sustainable management of natural resources including by stopping the further liberalisation of trade in natural resources such as forests, fish, oils, gas, metals and minerals."[153]

[153] Our World is Not For Sale (OWINFS) Statement, 2005.