is free trade fair trade?

new perspectives on the world trading system

Edited by Professor Frank Trentmann

THE SMITH INSTITUTE

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Preface
Paul Hackett, Director of the Smith Institute

The global financial crisis and slowdown in economic growth has far-reaching consequences for the world's trading system and globalisation. After a quarter of a century of strong growth and market liberalisation, world trade volumes are forecast to decline this year. This sudden contraction presents an enormous challenge to trade ministers and the World Trade Organization, which is struggling to revive the aborted Doha round of multilateral trade talks. As this publication makes clear, the threat of protectionism and tariff wars will have serious social and economic effects, especially in developing countries where free and fair trade is often a critical feature of combating poverty and maintaining political stability.

It is against this background that the distinguished authors of this publication present their views on what we have learned from the history of trade liberalisation and address what could be done today to ensure that trade policy remains a force for prosperity and social justice. As the WTO director general, Pascal Lamy, commented recently, "for national policy makers in the industrialised world, disregard for rising public concern about some aspects of globalisation would threaten to undermine the legitimacy of governments and imperil social support, as would neglect of the gains from trade. The answer to this tension lies in a balance between open markets and complementary domestic policies, along with international initiatives that manage the risks arising from globalisation." Britain and the EU have their part to play in achieving that balance, and we hope that this monograph will help inform their policy thinking.

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The Smith Institute, founded in memory of the late Rt Hon John Smith, is an independent think tank that undertakes research, education and events. Our charitable purpose is educational in regard to the UK economy in its widest sense. We provide a platform for national and international discussion on a wide range of public policy issues concerning social justice, community, governance, enterprise, economy, trade and the environment.

Chapter 1

The three meanings of fair trade

Professor Jagdish Bhagwati, Professor of Economics and Law at Columbia University and Senior Fellow of the Council on Foreign Relations

The three meanings of fair trade

If you follow the public debates on trade policy, you are likely to hear:

- first, a Detroit car manufacturer say that Japanese and Korean governments provide their car producers with "unfair trade" advantage in competition because their markets are closed while the US car market is open; or
- second, a typical politician (even Obama) in the United States say, "I like free trade but free trade must also be fair," and that the poor countries trade unfairly when they do not have the labour standards that the AFL-CIO (the federation of American labour unions) wants for America's rivals abroad; or
- third, a British charity accuse the developed countries of indulging in "unfair trade" because wages in the poor countries and their export prices are low and "should" be higher, urging that we buy from procurement agents who pay "fair trade" higher-than-market prices to poor-country suppliers and ask us to boycott cheap goods from the poor countries.

You may well then wonder when you encounter, as you must, the demand that we must deplore the absence of fair trade and insist on its acceptance, what exactly the activist or agitator for "fair trade" means by the phrase and therefore what exactly you are supposed to do to advance it.

In any serious discussion of "fair trade", then, we must be clear about the different meanings attached to it. Far from being simple and straightforward, the three meanings of "fair trade" differ dramatically and lead to radically different policy propositions. A generic appeal to "fairness" should not distract from the merits of free trade. For free trade has a fine record of success in bringing about prosperity and pulling up the poor from poverty in the poor countries.[1]

The nexus between freer trade and poverty reduction follows from two linked arguments: that freer trade generally leads to more rapid growth; and that accelerated growth generally pulls the poor people out of poverty.[2] The evidence in favour of both arguments is

1 See my book: *In Defense of Globalization* (Oxford University Press, 2004) (revised paperback edition, 2007), especially chapter five

2 I have argued frequently that the phrase "trickle-down" for the effects of the growth strategy is completely at variance with the way I, and others, thought of the growth strategy for reducing poverty. Trickle-down suggests that, as in Robin Hood films, the feudal lords and their bourgeois friends and vassals are eating legs of mutton and venison at the high table, and the crumbs fall to the serfs below the table. Instead, I have successfully put into circulation the phrase "pull-up" strategy, which suggests correctly a radical, activist developmental strategy that sees growth, accelerated by good policies that include outward orientation in trade, as a way of pulling people out of poverty through creation of jobs and economic opportunities.

considerable; and most analysts are now of the view that if countries like India and China failed to make a significant dent in poverty right up to the 1980s, that was not because the "pull-up" strategy did not work but because the policies pursued were so bad that growth did not materialise.

1. "Fair trade" in the sense of asymmetric openness of your market

The most commonplace use of the "fair trade" phrase in the trade policy discourse is in the sense that my country is open and my activity (for instance, semiconductors or agriculture) competes with rival producers in countries that are closed.

As Britain came to the end of the 19th century, and protectionist Germany and the United States emerged as major trading nations, British unilateral free trade was seen as the source of Britain's relative decline. "Fair trade" demands, to abandon free trade, became rampant, as Britain became a victim of what I have called the "diminished giant syndrome". Similar demands grew in the US vis-à-vis Japan in the 1980s, as Japan seemed to be overtaking the US and the fear grew that the 21st century would be Japanese just as the 19th had been British and the 20th had been American.

The irony was that, unlike in the case of 19th-century Britain, the 20th-century obsession in America with Japan's autarchy was more imagined than real. To see this, we need to distinguish between "openness" and "penetrability". Think of your childhood Tarzan films. If you wish to get into the jungle, you may not be able to do so because the chief inside is shooting poisoned arrows at you: this is like autarchy. But suppose he is benign. You may then not be able get through the jungle because of the tall grass and the pits dug to catch prey but which you fall into instead, so that the open jungle is not penetrable unless you mount an expensive safari.

The US car market was in fact closed (though not fully) by a voluntary export restraint of 2.2 million Japanese cars. But the Japanese market was open; the exports to Japan, however, were small. The US market was tougher to get into, at the margin, because quota restraints cut off imports once filled. On the other hand, efforts at penetrating the Japanese market would not face such a constraint.

Regardless, the argument that we would suffer if Japan closed its markets to our firms, whereas Japanese firms could access our markets, turned out to be potent. First, because it seemed, as in end-of-19th-century Britain, to be simply "unfair". But more so because the theory of unilateral free trade (which prime minister Robert Peel had embraced) suggests that if we can get Japan to liberalise as we do, that would be a double dividend: we gain from Japan's and our liberalisation, twice over.

But suppose that Japan refuses to liberalise; then we ought to liberalise unilaterally. Peel, when he unilaterally repealed the Corn Laws in 1846, had despaired of getting the French to liberalise as well and embraced unilateral free trade. But he also believed in what I have called "induced" reciprocity. Peel was convinced that Britain's prosperity resulting from the repeal of the Corn Laws would induce the French to follow suit.

In fact, it is not just example, but also the fact that a higher trade participation in Japan following US freeing of trade could increase the political clout of the pro-trade lobbies, thus inducing the Japanese freeing of trade down the road.[3]

Paul Krugman produced an argument that suggested that unilateral trade liberalisation by the US, or asymmetric openness of the US, would harm it. He assumed two identical Japanese and US firms. Both had identical cost curves with scale economies that meant that the more you produced, the lower your cost. If the Japanese market was closed and the US market was open, then the Japanese firm would have two markets while the US firm would have one, so the Japanese firm would achieve lower cost because of larger scale, and the US firm would lose – and, under certain circumstances, the US itself would suffer a welfare loss.

The problem with this argument is that it assumes that, despite free trade or protection, the firms would have identical cost curves. We know, from much experience, however, that firms under protection tend to "goof off" and become inefficient. So the Krugman argument, while correct analytically, was wrong because the assumptions underlying it were unrealistic. Few today buy into this qualification of the case of unilateral trade liberalisation.

2. "Fair trade" as requiring that rival producers abroad carry the same burdens on labour standards, domestic environmental costs and the like as you do

But the phrase "fair trade" has been used, for decades, in the US (and hence in policy discussions among international trade economists, bureaucrats and politicians) in a second, different sense: if our trading partners do not share our labour and domestic environmental standards, so that the same industry across countries has different cost burdens, then that is tantamount to unfair trade. I have written extensively showing why it makes no sense to iron out these cross-country intra-industry (CCII) differences, because there are legitimate reasons to have these differences.

3 These issues have been discussed by me in several places, including lecture 3 in *Free Trade Today* (Princeton University Press, 2002). For evidence on unilateral trade liberalisation, and also some theory, see: Bhagwati, J (ed) *Going Alone* (MIT Press, 2004)

For instance, if Mexico has bad water and good air, relative to the US (where people have filters, bottled water and also better water supply from the tap, whereas there is a lot of emission of carbon-dioxide from many more cars), it would make sense for Mexico to clean up the water rather than its air. The result would be CCII differences in the same Mexican and US industries relating to water and to air pollution.[4]

In fact, what motivates these erroneous demands is the desire to "level the playing field". What is outrageous and galling to people in the poor countries is that while these "fair trade" demands in the rich countries like the US are made to reduce competition from the poor countries, and therefore reflect fear and self-interest, they are often presented as if these demands were prompted by altruism and empathy: "Oh, we are demanding this for *your* workers!"

So "fair trade" in this usage is just a euphemism for protectionism. It is, in fact, "export protectionism", which is both invidious and insidious. It aims to reduce the force of competition by trying to raise the cost of production abroad, instead of by import protection. To see this, imagine that a beast is charging at you. You can break its charge by either catching it by its horns (import protectionism) or by reaching behind it and catching it by its tail (export protectionism).[5]

And, of course, if these trading partners did not accept the demands to raise labour and environmental standards (and much else) prior to free trade, then free trade would be withheld. We would then have conventional import protectionism, justified by the slogan that free trade without fair trade was unacceptable. It is a lose-lose proposition for the poor countries.

3. "Fair trade" in the sense that we should pay a "just", rather than the market, price for what we import from the poor countries

Big British charities such as Oxfam, which have branched out (like big businesses diversifying into new products) into areas such as trade policy, seem to have turned instead to a yet older tradition in the UK from the time of the Quakers, such as the Rowntrees who wished to pay a "fair" price for cocoa beans which they processed into their chocolates. In doing this, they were, of course, blissfully ignorant of the fact that the phrase "fair trade" was used everywhere to indulge in protectionism! They were unwittingly providing legitimacy to the phrase "fair trade" and hence to protectionism.

4 See, in particular: Bhagwati, J and Hudec, R (eds) *Fair Trade & Harmonization: Prerequisites for Free Trade?* volumes 1 and 2 (MIT Press, 1996), especially chapter 4 in volume 1

5 President Obama will have to understand this for himself as he is besieged by labour unions such as the AFL-CIO and its affiliates, and by economists who know that they must go along to get along in the new administration, and therefore does not have a clear understanding of the protectionism in the demands for "fair trade" from these groups in his Democratic Party.

Should we, however, pay higher-than-market prices for "fair trade" coffee, for example? If such coffee is offered as one more option in, say, Starbucks, that is perfectly fine, of course. In effect, such fair trade coffee is to the consumer a way of subsidising the production of that coffee. If that is the way a consumer wants to direct his charity, this is well within her right to be altruistic in the way she pleases. But I may choose from several other options, like contributing to the digging of a well in the village, or financing an NGO that works on building schools for the underprivileged.

Unfortunately, the campaigns for "fair trade" goods often degenerate into demands that only the fair trade option should be available, and they seek to impose their products to the exclusion of others. That is surely not acceptable. It is ironic that one set of people who wish to practice virtue – and that is admirable indeed – should want to act immorally by riding roughshod over our wanting to practice virtue according to our own consciences.

Chapter 2

Freer trade and higher incomes – how much do we know?

Professor L Alan Winters, Professor of Economics at the University of Sussex, Research Fellow at the Centre for Economic Policy Research in London and Chief Economist, Department for International Development, London

Freer trade and higher incomes – how much do we know?

This essay explores the proposition that freer trade normally leads to higher incomes. It is sympathetic to that view, but argues that only recently has the science become sufficiently robust that we can have confidence in it. Even now one must retain a degree of scepticism about what the protagonists in this debate claim and must assess carefully their evidence. This essay offers a brief, non-technical guide to help in making that assessment. It starts with a few preliminary definitions, explores the difficulties of assembling convincing evidence and spells out why recent work is an improvement on its predecessors. Finally it discusses a few of the issues surrounding the achievement of freer international trade.

Preliminaries

Why are we interested in freer international trade? For the sake of this brief essay, I shall assume that it is because we want to know whether it will raise incomes and that we want to know this because freeing trade is technically, if not politically, a straightforward policy that almost any government can pursue.

That, in turn, begs a number of questions. First, for brevity all the discussion here will be in terms of average incomes per head in liberalising economies, but one might also be concerned about income distribution, or at least about the incomes of the very poorest. The evidence suggests that trade liberalisation has, on average, roughly neutral effects on income distribution (as many improvements as worsenings), but that it almost always raises the average incomes of the poor in absolute terms.[1]

Second, I need to clarify "freer trade". Strictly, there is no such thing as free trade – all international trade costs effort to conduct – but we could imagine international trade free from all interferences by government. Even this is relatively rare, however: many imports pay no tariff but still face inspection for, say, conformity to local safety standards. Hence I shall be pragmatic here and consider trade *relatively* free from official frictions and conducted with *relatively* efficient logistics and physical infrastructure.[2]

Third, the link from trade policy to incomes is sometimes held to entail two separate stages – from trade policy to trade, and from trade to income. In fact this is not strictly

1 See: Winters, LA "International Trade and Poverty: Cause or Cure?" in *The Australian Economic Review* vol 39, no 4 (2006), pp347-58

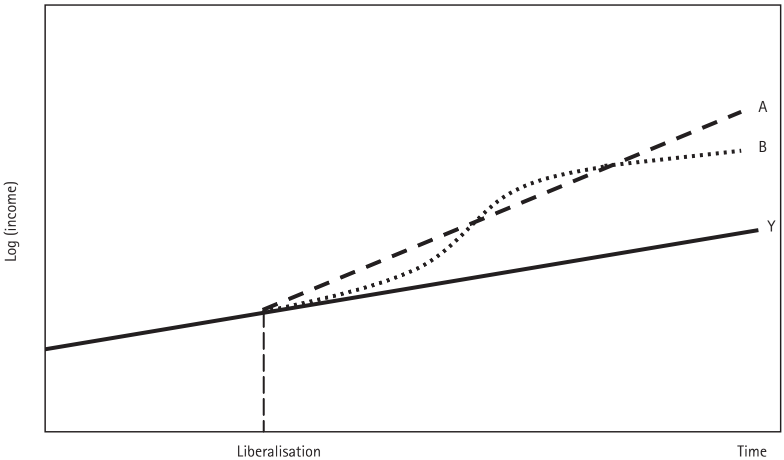
2 I refer to restrictions that a country puts on its own trade – exports or imports. This is what can be controlled, and while partners' restrictions are harmful to a country's welfare, they are generally less so than what it does to itself. Access to partners' markets is fairly similar for all exporters, but some prosper and some do not. This alone suggests that the main drivers of performance are country-specific.

true: as a local producer I may exert myself to be efficient, not because Britain already imports competitive goods from abroad, but because I recognise that if I did not exert myself, it could. That is, potential import competition may be sufficient to boost incomes. Also, economists often use the value-of-trade value as a proxy for trade policy and hence deliberately conflate the two stages.

Fourth, we have to consider time: trade liberalisation could have one of two effects on the path of incomes as illustrated by figure 1, which plots the income of a notional economy over time. Assuming that, in the absence of any change, income would have progressed along path Y, liberalisation could cause a permanent change in the underlying growth rate of income – as in path A – or it could shift the economy on to a higher but parallel growth path as illustrated by path B. In the second case we would observe actual growth rates in excess of the underlying rate while the change occurred, but eventually growth would settle down to its original rate albeit at a *higher level* of income.

The difference between these two possible effects of liberalisation on incomes is important for assessing the very long-run benefits of trade reform, but, unfortunately, given that major transitions can take decades, it is very difficult to tell the two possibilities apart in practice. My own view, based on evidence from Hall and Jones,[3] is that while liberalisation permanently enhances income levels, the growth benefits, while long lived, are transitional.

Figure 1: Permanent versus temporary changes in growth rates



3 Hall, RE and Jones, CI "Levels of Economic Activity across Countries" in *American Economic Review* vol 87, no 2 (1997), pp173-177

The debate in the 1990s

Economic theory offers many reasons to expect a country's own trade liberalisation to stimulate its economic growth:

- specialising in goods for which world prices exceed those that would be available at home;
- reaping economies of scale;
- improving performance in the face of new competition; and
- benefiting from better inputs and technologies available from abroad.

None of these is guaranteed, though, so ultimately whether trade does stimulate income is an empirical matter. Over the 1990s several highly visible global cross-country studies argued that openness was good for growth/income. They all suffered severe criticism by Rodriguez and Rodrik,[4] however, who showed that their measures of openness were not appropriate to the theories they propounded, that their results were sensitive to particular but extraneous features of the data, and that the econometric methods they used failed adequately to identify causation running from trade liberalisation to growth. Rodriguez and Rodrik also found it hard to replicate some of the results in the literature, raising some concern about their accuracy.[5]

The difficulty of establishing an empirical link between liberal trade and economic growth arises from at least four sources.[6] First, once one comes inside the boundary of near autarchy, it is difficult to measure a country's trade stance: for example, tariffs need to be aggregated across goods, quantitative restrictions assessed and then aggregated, and the levels of predictability and enforcement measured.

Second, causation is difficult to establish. Actual openness, which is usually measured by the ratio of trade to national income, is almost certainly a *result* of growth as well as a possible cause. But there is also concern that even policy-based measures, such as

4 Rodriguez, F and Rodrik, D "Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-national Evidence" in Bernanke, B and Rogoff, KS (eds) *Macroeconomics Annual 2000* (MIT Press for National Bureau of Economic Research, 2001), pp261-324

5 The weight borne by cross-country studies in the literature on economic growth in the 1990s is remarkable, given that so many economists professed to distrust them. After all, why should all countries respond the same way? None the less, the attraction of simple rules and generalisations seduced much of the profession into citing their results when giving policy advice. In dismissing Rodroguez and Rodrik's contribution, Srinivasan and Bhagwati chide the economics profession for ever having taken these studies seriously – see: Srinivasan, TN and Bhagwati, J "Outward-orientation and Development: Are Revisionists Right?" in Lal, D and Snape, RH (eds) *Trade, Development & Political Economy: Essays in Honour of Anne O Krueger* (Palgrave, 2001)

6 Winters, LA "Trade Liberalization and Economic Performance: An Overview" in *Economic Journal* no 114: F4-F21 (February 2004)

average tariffs, could face the same problem, because growing countries might be more willing to liberalise.

The third challenge is that, while liberal trade policies are likely to be somewhat beneficial under any circumstances (because they enlarge the set of opportunities for economic agents), anything beyond a short-term effect on growth requires combination with other good policies and sound institutions as well. This makes it difficult to isolate the individual effects of trade reform. Indeed, it raises the question of whether it is even worth trying to do so if policies always come in packages. It also calls for special tools if the argument is that liberal trade is necessary for growth, but not sufficient - that is, that it will not be advantageous if other conditions are not right.

The situation becomes even more complex if, fourth, openness *causes* improvements in other policies and institutions. As examples, countries with simple open trade regimes appear to be less corrupt, and open economies have less inflation.

Recent evidence that trade liberalisation is beneficial

Since 2001 further work has re-established to most economists' satisfaction that openness really does enhance income – at least conditionally. Researchers have worked hard to establish causation by isolating those parts of international trade that are genuinely exogenous to (that is, not caused by) income and asking if they in turn cause higher incomes: it turns out that they do. For example, Noguer and Siscart[7] find that that part of trade that is due to countries' size and location contributes to higher income. Populous and rich countries and the countries close to them apparently trade more and gain income accordingly.

Researchers have also explored the set of appropriate complementary policies if liberalisation is to have strong effects. They include at least a minimal degree of labour market flexibility, firm entry flexibility, financial access and human capital investment.[8] Many studies have associated openness with faster accumulation (that is, investment)[9] – and so a poor investment climate could undermine the benefits of trade reform. For example, if labour regulation is too restrictive, opening up could reduce incomes, whereas under more flexible regimes it would stimulate them. The problem is that while the negative effects of

7 Noguer, M and Siscart, M "Trade Raises Income: A Precise and Robust Result" in *Journal of International Economics* vol 65, no 2 (2005), pp447-60
8 Freund, C and Bolaky, B "Trade, Regulations, and Income" in *Journal of Development Economics* vol 87, no 2 (2008), pp309-321
9 For example: Warziarg, R "Measuring the Dynamic Gains from Trade" in *World Bank Economic Review* vol 15, no 3 (2001), pp393-429

increased competition on import-competing firms cannot be avoided, so that jobs and investment are lost, a rigid economy cannot effectively shift the resources so released to expanding exporting industries. In short, the economy cannot respond to new incentives.

A strong branch of development theory holds that the primary determinant of economic growth and higher incomes is the quality of institutions, and no observer could deny them at least some role. In a "horse race", Rodrik, Subramanian and Trebbi[10] argue that institutions far outperform geography and openness as explanations of real income per head and, indeed, that given institutions, openness has an (insignificantly) negative effect. They find, however, that openness partly explains the quality of institutions and so has a positive indirect effect on incomes. In fact, in their work, openness is the *only* variable that can be manipulated to affect institutions, and hence they unwittingly lend support to trade liberalisation as an income-enhancing policy.[11]

Recent research has also exploited longer time-series of data and offered a number of statistical case studies. Wacziarg and Welch[12] find considerable variations in experience across countries and between different periods of time; their cross-country results are suggestive of, and their detailed country studies strongly supportive of, the benign effects of trade liberalisation. Further recent research has provided detailed narrative case studies that have found openness at the heart of development – for example, Reinikka and Collier on Uganda.[13] And more recently still, the Growth & Development Commission[14] found that exploiting the opportunities provided by world markets (both to sell exports and obtain cheap imports) is one of the few common features of countries that have had successful long-run growth experiences. Indeed, no country has developed since the Second World War without significantly relying on overseas markets.

Further evidence on the link between openness and income examines possible causal links between openness and growth separately. I have already mentioned investment. A second key link is between openness and productivity. The evidence from studies at country, sectoral and firm level suggests very strongly that opening up international trade stimulates productivity. Part of the way in which it does so is by allowing more efficient (exporting) firms to grow faster than less efficient ones, and allowing import competition

10 Rodrik, D, Subramanian, A and Trebbi, F "Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development" in *Journal of Economic Growth* vol 9, no 2 (2004), pp131-65
11 Winters, op cit (2004)
12 Wacziarg, R and Welch, KH "Trade Liberalization and Growth: New Evidence" in *World Bank Economic Review* (forthcoming), also published as National Bureau of Economic Research working paper 10152 (December 2003)
13 Reinikka, R and Collier, P *Uganda's Recovery: The Role of Farms, Firms, & Government* (World Bank, 2001)
14 Commission on Growth & Development *The Growth Report: Strategies for Sustained Growth & Inclusive Development*, report of the Commission on Growth & Development chaired by Michael Spence (World Bank, 2008)

to pick off weaker domestic firms – adjustment again – but we also see evidence of improvements within firms.[15]

Such rationalisation may harm the workers and owners of failing firms, but, equally clearly, long-term progress requires adaptation and adjustment. The key is to allow firms to fail but to ensure that new opportunities can arise to take their place. If we had not done this already, Western societies would be full of out-of-work (or protected) candle-makers, steam engine firemen and coalminers – as described in Bastiat's 19th-century satirical commentary.[16]

Despite the methodological difficulties, and the continuing need for vigilance about the technical quality of new studies, the weight of experience and evidence now seems strongly that openness enhances income. To be sure, there are variations across circumstances and no one pretends that trade is the only thing that matters, for trade liberalisers have to undertake other reforms as well. Moreover, even the critics[17] concede that there is no coherent evidence that openness is bad for income.

One might think of parallels with the debate on smoking. There was a long period during which the weight of evidence was sufficient to convince most rational people that smoking was harmful to health, but in which complete proof to either scientific or judicial standards had not been achieved. And during this period, just as with today's openness and growth debate, the hold-outs would cite specific counter-examples as if they overturned the general presumption.

Trade liberalisation and trade since 1947

Following the Second World War, international trade was pretty highly restricted and trade liberalisation has been proceeding, at least partially, since then. The creation of the General Agreement on Tariffs & Trade or GATT in 1947 initiated a series of multilateral rounds of tariff reductions on imports of industrial goods into developed countries, which has cut average non-preferential tariffs from between 20% and 30% to below 4% by 2005. In addition, most industrial countries had reduced or removed many non-tariff barriers, a process that started in 1950 under the auspices of the Organisation for European Economic Co-operation (OEEC, the precursor of the OECD, the Organisation for

15 For example: Fernandes, AM "Trade Policy, Trade Volumes and Plant Level Productivity in Colombian Manufacturing Industries" in *Journal of International Economics* vol 71, no 1 (2007), pp52-71
16 Bastiat, F *A Petition from the Manufacturers of Candles, Tapers, Lanterns, Sticks, Street Lamps, Snuffers, & Extinguishers, & from Producers of Tallow, Oil, Resin, Alcohol, & Generally of Everything Connected with Lighting* (1845) (http://bastiat.org/en/petition.html)
17 Rodriguez and Rodrik, op cit

Economic Co-operation & Development) and continued in fits and starts until the end of the century.

Progress has, as is well known, been much slower on industrial countries' agricultural imports, having gone into reverse several times, and also in services trade. Indeed, in the latter case, the World Trade Organization has hardly started on multilateral liberalisation, although industrial countries – acting individually, in regional blocs, and worldwide through the OECD – have notched up significant progress in particular sectors.

The situation for developing countries has been rather different. Many were not part of the GATT, and even when they were, they were not encouraged to liberalise very much. The almost universal model of development over the 1950s to 1970s was import substitution, which encouraged newly independent countries to increase rather than reduce levels of protection relative to their colonial days. Thus by the 1980s developing country tariffs were high. It is difficult to obtain data, but a compilation by the World Bank[18] suggests averages for low- and middle-income countries during 1981-84 of 38% and 30% respectively, which have now (2003-06) fallen to 13% and 9%. Non-tariff protection has probably also fallen, but this is hard to ascertain with confidence.

The data in the two previous paragraphs refers to non-discriminatory tariffs, but actual average tariffs are even lower now: industrial countries offer reduced (preferential) tariffs to developing countries, and most countries offer reductions (to zero) to partners in so-called regional trading agreements.

For a sample of developing countries, Martin and Ng[19] estimate the relative weights of these forms of liberalisation. Of a reduction in the weighted average non-discriminatory tariff of 18.6 percentage points (from 29.9% to 11.3%) between 1983 and 2003, 5.1 percentage points arose from the GATT's Uruguay round and 13.5 percentage points from autonomous decisions to liberalise, participation in World Bank/International Monetary Fund adjustment programmes and liberalisation associated with WTO accession. Regional arrangements currently agreed are expected to induce a further reduction of around 2 percentage points, leading to total tariff reduction of 20.6 percentage points.

International trade and income have increased at unprecedented rates over the period of these trade liberalisations – world exports at a rate of 6.2% per annum over 1950-2005 and world GDP at 3.8% per annum. It is difficult to believe that this has nothing to do

18 Ng, F "Data on Trade and Import Barriers" (2008) (http://www.worldbank.org/trade, consulted on 5 August 2008)
19 Martin, W and Ng, F "A Note on Sources of Tariff Reductions in Developing Countries 1983-2003", mimeo (Development Research Group, World Bank, 2007)

with trade liberalisation, although clearly there are other causal factors such as transport and communications costs as well.

None the less, an interesting debate has occurred recently over how much of the trade increase is due to the GATT/WTO. Rose[20] argued that essentially none was, particularly after the first couple of rounds of negotiations. But this conclusion was overstated because, out of the many estimates that Rose presents, those using the most appropriate method suggest significant and relatively strong effects.[21] Moreover, as Tomz, Goldstein and Rivers[22] show, if one identifies participation in the GATT correctly, the results, while not without a few puzzles, suggest very strongly that the GATT and WTO have had a strong positive effect on trade volumes.

In a related paper, Goldstein, Rivers and Tomz[23] compare the trade-increasing effects of the GATT/WTO with those of being part of the same colonial orbit or the same regional trading agreement or RTA. All have positive effects on the amount of trade, with colonial effects largest at first but declining to zero by the mid 1980s, the GATT being large initially but declining to only around 10% by 2000 (although there are problems of measurement in the last few years) and RTAs growing from nothing in 1960 to 64% by 2000.

The impression from the discussion above may be that all liberalisations of international trade are equivalent, but this is not true. RTAs may boost trade, but at the expense of distorting it. Instead of purchasing imports from the most efficient source, consumers may purchase from the one that pays the least tax. This is fine from their point of view, but rather than part of the price going to the government it now all goes to the foreign supplier, so the cost of the import to the country as a whole goes up. Moreover, competition between a few members of an RTA may be more easily managed and manipulated than worldwide trade, so that the competitive pressure effect of RTAs is weaker than that of non-discriminatory trade.

Advocates of RTAs accept these possibilities but argue that since an RTA may affect more goods and services and liberalise them more deeply than multilateral liberalisation, they

20 Rose, A "Do We Really Know that the WTO Increases Trade?" in *American Economic Review* vol 94, no 1 (2004), pp98-114
21 Rose writes (p105): "Cognoscenti may prefer the fixed-effects estimation" in table 3. Contrary to his statement that these are "moderate, often insignificant, and sometimes negative", they are quite large (up to 113%) and always statistically significant except for one negative result.
22 Tomz, M, Goldstein, JL and Rivers, D "Do We Really Know that the WTO Increases Trade? Comment" in *American Economic Review* vol 97, no 5 (2007), pp2,005-2,018
23 Goldstein, JL, Rivers, D and Tomz, M "Institutions in International Relations: Understanding the Effects of the GATT and the WTO on World Trade" in *International Organization* vol 61, no 1 (2007), pp37-67

may still be beneficial. This is another area that awaits convincing empirical resolution, but the evidence so far is not flattering. Vamvakidis[24] finds that while multilateral liberalisation boosts growth (although see our strictures above), RTAs do not; Wooster, Dube and Banda[25] find that intra-EU trade has less effect on EU growth than extra-EU trade, and Jacquemin and Sapir[26] find that EU imports from outside the union constrain profit mark-ups while intra-imports do not.

Conclusion

The effects of trade liberalisation on income are not easy to pin down precisely, and quite certainly vary in detail from case to case. But the weight of evidence now strongly favours the view that openness enhances economic performance in terms both of average levels of income and of poverty.

Since 1947 – the birth of the GATT – liberalisation has nearly been completed for industrial countries' imports of industrial goods (less so for agriculture), and since 1980 it has also occurred rapidly in developing countries. A substantial part of this progress is due to the GATT/WTO itself. It has been accompanied by historically unprecedentedly high rates of income growth in many, although for a variety of reasons not all, countries.

We now clearly understand that liberalisation needs to be accompanied by a series of other measures designed to help markets function, industries adjust and production increase. Countries do not need to wait until these things are in place before liberalising (you would wait for ever!) but in their absence the returns will be smaller.

The finding that liberalisation is good for growth might seem rather depressing in August 2008, when the Doha round of trade talks hit yet another bump in the road: would not failure imply less liberalisation and hence less growth? That is true, but there are several mitigating factors:

- Doha is not dead yet;
- Doha does not address many dimensions of trade liberalisation that are possibly more important than goods tariffs – such as liberalising services barriers and dealing with standards;

24 Vamvakidis, A "Regional Trade Agreements versus Broad Liberalization: Which Path Leads to Faster Growth? Time-series Evidence" in *IMF Staff Papers* vol 46, no 1 (March 1999), pp42-68
25 Wooster, RB, Dube, S and Banda, TM "The Contribution of Intra-regional and Extra-regional Trade to Growth: Evidence from the European Union" (16 January 2007) (http://ssrn.com/abstract=957715)
26 Jacquemin, A and Sapir, A "Competition and Imports in the European Market" in Winters, LA and Venables, AJ (eds) *European Integration: Trade & Industry* (Cambridge University Press, 1991)

- most developing countries already have tariffs well below the rates they have bound in the WTO (binding means making a commitment not to exceed a particular level, and this is what is negotiated in the WTO) and so not much liberalisation is on offer anyway;
- for this and other reasons, the Doha round does not maximise its potential for poverty alleviation;[27] and
- finally, and most importantly, the liberalisation of the tariffs actually applied can proceed without the WTO, so if governments accept the evidence above, they can proceed by themselves and let the WTO catch up when it can.

Thus the dangers inherent in the Doha round failing are not what it offered relative to the current situation, but that failure would suggest a failure of international co-operation in general, and that the current situation might gradually dissolve into a much more protectionist world.

Postscript

Since this chapter was completed in August 2008, the world has experienced a deep and far-reaching financial crisis that is certainly leading to a serious economic downturn in the industrial economies. The initial problems were financial, and contagion between countries occurred because financial sectors were interlinked, and confidence in virtually all was shaken. The subsequent economic shock, however, is spreading around the world because different parts of it are linked by international trade – markets for exports are declining and, particularly for commodities, world prices are falling.

In November 2008 it is too early to know how it all will turn out, and one cannot with confidence assert that its consequences will not be serious. However, so far nothing has occurred that would change the case for openness made in this chapter. Some people will be hurt badly by the crisis, but, on average – the basis on which virtually all macro-economic policy (indeed virtually any social policy) has to be made – the effects have not yet been very large: a few countries have seen output decline by a few tenths of 1%.

Hence, in terms of aggregate income, the gains of the previous decade and a half of strong growth far outweigh the current downturn. Even weighting negative shocks several times more heavily than positive gains (on the grounds that they upset us more than the gains please us), there is no comparison. For the people who are hurt, the crisis entails losses, but the appropriate approach to their suffering is to make serious efforts to

27 Hertel, TW, Keeney, R, Ivanic, M and Winters, LA "Why Isn't the Doha Development Agenda More Poverty Friendly?" *Review of Development Economics* (forthcoming)

mitigate their problems rather than sever the links between national economies. The latter would amount to saying that no one should be allowed to take the risk of growing lest someone fall.

Of course, the crisis may deepen and eliminate several years' gains, as the setbacks of the 1930s did. Should we then conclude that openness has been a mistake? The losses would have to be huge to warrant such a conclusion in retrospect. And, moving forward, to advocate a policy of weakening international commercial links, we would have to believe that the best way out of a slump was "every country for itself" rather than a globally co-operative approach. The beggar-thy-neighbour policies of the 1930s are mostly held to have worsened the slump (in some scholars' minds even caused it) rather than to have aided recovery, so to believe this in the 2000s would require a large change in our understanding and/or the evidence of the past.

My tentative guess at present is that the crisis of 2008 will reduce incomes in developing countries by perhaps 4% of what they would have been if strong growth had continued to 2010, and that at least some of that shortfall will be made up by slightly faster growth subsequently. Moreover, the last decade has been unprecedented, so the assumption that growth would have continued unchecked is far from self-evident. Without doubt, there are lessons to learn about financial and economic management, but retreating from global economic integration is not one of them.

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Chapter 3

When free trade was fair – lessons from an earlier era of globalisation

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When free trade was fair – lessons from an earlier era of globalisation

We are so accustomed to view "free trade" as a rational economic model, strengthened over time through various technical adjustments, that it is difficult now to appreciate the passionate loyalties the subject generated in the past. I am not here trying to minimise the gains from recent work in trade theory. Rather I would like to make a historically informed case for the retrieval of the social, ethical and political dimensions of free trade.

Since last summer (2008), the collapse of the World Trade Organization's Doha round of international trade talks, followed by the crisis of the world financial system, has raised fears of a retreat from globalisation and of a new protectionist era. The history of globalisation, of course, does not proceed in a smooth linear direction, and earlier reactions such as the economic imperialism and nationalism of the 1930s are well known. Such retreats, however, are not inevitable. There have also been times, like the 1880s-1900s, when Britain rallied to the defence of free trade and withstood the protectionist drift that saw the rise of barriers to trade elsewhere.

Not unlike the United States today, Britain then was a global power in relative decline. One fundamental difference is that, unlike today, free trade in Britain managed to mobilise a mass movement. Free trade meant wealth and cheap food, but it was more than that. It stood for social fairness, citizenship and peace. That free trade in Britain successfully repelled the threat of protectionism before the First World War had a lot to do with the broader political armature of the economic idea. It also was connected to a type of political campaigning and communication that looked to people's emotions and identities, not only their rational interest.

At a time when the protectionist mood is rising, this earlier history has lessons for today. The world economic crisis has sparked proposals for a "Bretton Woods II", a new international order that might combine the restructuring of the financial system with greater sustainability and a reform of the world trading system around "aid for trade". To be successful, however, any future trade order needs more than just another set of international institutions. It requires democratic reform from the bottom up. It is in this context that the earlier politics of free trade may have some valuable lessons.

How popular support won the day for free trade

To give you a sense of the flavour of free trade a century ago, let me take you back in time to 1910, to the town of High Wycombe, where a dramatic battle unfolded during the general election that January. Just as a final group of men was proceeding through the centre of town to cast their vote, mayhem broke out. A stone was thrown, shattering the screen of a motor car. Then, as the town clock struck 8pm, a crowd of free trade supporters stormed the Conservative "Dump Shop". This dump shop was a protectionist exhibit of cheap goods made by cheap foreign labour. The protesters were fighting to keep Britain a free trade nation, where foreign goods could enter freely, without any penalties – the protectionists, by contrast, wanted to introduce a tariff to give British and imperial goods an advantage over foreign imports.

Already, a few days before, at the advice of the Chief Constable, the shop had been boarded up. Now the crowd tore down the boards and knocked in the windows. A helpless policeman was pushed through the window of a neighbouring shop. Officers drew their truncheons and fought running street battles – to no avail. Within minutes, the shop was torn to pieces, including windows, gas fixtures and exhibits. With loud cheers, free traders piled up the contents in a large heap and set them on fire "by means of rockets and otherwise".

Some of the protesters were young men, some were intoxicated, but there were also respectable artisans and workers such as Frederic James, a chair maker, who was caught with a man locally known as "Cheshire Cheese" armed with hammers and sticks. The carrier William Hoskins certainly did his bit to add to the commotion – driving his cart and pony at great speed through the crowd – at 16 miles per hour, according to a police witness – not just once but three times, knocking down the captain of the fire brigade and interfering with the police.

The following day, things went from bad to worse. After further confrontations, the Riot Act was read. Standing two deep in a line, the police drew their batons and charged the crowd, bludgeoning it "unmercifully". The next morning, there was blood splattered across town. Over 30 wounded were in the care of the local doctors, Fleck and Bell.

These scenes from Britain in 1910 are revealing on several counts. They show, firstly, how popular passions about globalisation have changed in the course of the last century. By the time of the WTO meeting at Seattle and the G8 meeting in Genoa in 2001, riots and popular violence would be associated with critics of an open world trading system, not its supporters.

The earlier free trade riot also points to a blind spot in standard explanations of protectionism. For most economists, free trade is as unquestionable as the law of gravity. Yet, in the real world, free trade has often found it difficult to keep protectionist forces at bay. To explain this deviation, most analysts refer to the costs and anxieties that trade openings bring in their train. It is an inherent problem, well restated recently by Ben

Bernanke, the chairman of the US Federal Reserve:[1]

[The] expansion of trade opportunities ... tends to change the mix of goods that each country produces and the relative returns to capital and labor. The resulting shifts in the structure of production impose costs on workers and business owners in some industries and thus create a constituency that opposes the process of economic integration.

Under this view, fears of cultural change and unjust enrichment distract from the public benefits of globalisation. Globalisation creates losers (real and imagined), and these happen to be concentrated in particular firms, trade sectors and regions. The benefits from open exchange, by contrast, are more widely dispersed.

There is some truth to this point of view, and the workings of lobbies have been well documented by political scientists. But it also misses a vital dimension. The history of free trade is not only determined by losers, nor simply by selfish interests. At crucial moments, free trade has also been able to mobilise the support of the many. Popular support was the decisive reason Britain managed to contain the protectionist threat before the First World War. The advancing institutionalisation of trade policy after the Second World War in international institutions such as the General Agreement on Tariffs & Trade (GATT), by contrast, was marked by greater distance to popular democratic movements. For a discussion of how to make trade more democratic and fair, then, the earlier democratic history of free trade offers one helpful context.

Free trade and the birth of the citizen-consumer

The moral case for free trade reaches back to the 18th century. Enlightenment thinkers argued that, in addition to advancing wealth, commerce softened war-like passions. By trading goods, merchants connected distant lands and cultures, advancing peace and understanding.

In the early 19th century evangelical religion turned free trade into a distinctly British civilising mission. Trade barriers were a defiance of God's will, evangelicals argued, especially the Corn Laws that had been introduced in 1815 to keep out cheap foreign grain. They hindered the spread of the gospel. As the veteran anti-slavery campaigner George Thompson told a large interdenominational conference in 1841, if news of the millions of Britons starving under the Corn Laws was to reach Africa, missionaries would face the "scorn of the barbarian".

1 Speech to the Federal Reserve Bank of Kansas City's 30th annual economic symposium at Jackson Hole, Wyoming, on 25 August 2006

Britain's repeal of the Corn Laws in 1846 marked the triumph of liberal trade policy, but it was not yet a genuinely popular, democratic cause. The Anti-Corn Law League had difficulty recruiting workers. Many radical Chartists were suspicious that free trade was just a manufacturers' scheme for low wages. In the rest of Europe, too, free trade was advanced by an alliance of middle classes and reform-minded elites, including Napoleon III, who contributed handsomely to the erection of a statue of Richard Cobden on Camden High Street in London.

What would set Britain truly apart was its dogmatic and increasingly popular defence of free trade in the late 19th and early 20th centuries, just as the rest of the world raised their tariff walls. The more open trading system of the 1860s was replaced by a new protectionism. In Britain, this battle reached its climax in the early years of the 20th century, when Joseph Chamberlain launched a "tariff reform" crusade hoping to replace free trade with imperial protectionism.

Unlike in the rest of Europe and in the United States, however, free trade repelled the protectionist challenge at the British elections of 1906 and 1910. Of course, many in the City and export industries had benefited from an open system. At the same time, many sectors, even firms, were politically divided on this question. In the last resort, the defence of free trade depended on popular support. Free trade managed to do in Britain under conditions of mass politics what it failed to do elsewhere or since: generate a national belief-system and an army of supporters across all classes.

One reason for the success was that free trade married older ideals of peace and commerce to new ideas of consumer power and citizenship. Lloyd George, the rising Liberal star and future prime minister, told Britons in 1903 that their holy mission was "to open up through our national market-place a path for the nations to tread to the Temple of Concord". Tariffs stirred "the evil passions", exciting "international jealousy, rage, envy, anger, greed". This was an older vision, but it was now tied to a parallel belief in free trade as a pathway to democracy. The repeal of the Corn Laws, in this view, was a milestone in the history of freedom. It liberated the British people from hunger and "an Egyptian bondage", according to *The Hungry Forties*, a bestseller that circulated in several hundred thousand copies before the First World War.

The association between free trade and citizenship was especially strong for those without the vote. Liberal and Co-operative women defended free trade as a quasi-constitutional bill of rights. Free trade ensured "the purity of politics", by preventing sectional interests from using political influence for economic gain. It guaranteed that all consumers were heard, not just those who had the vote, but also women, the "chancellors of the exchequer" in their homes.

In addition, free trade helped women to acquire the democratic qualities that would prepare them for full citizenship. In the "biggest and best demonstration" ever held by the Women's Co-operative Guild, at the Free Trade Hall in 1903, Mrs Bury reminded a crowded audience that "co-operation and free trade started together, and they had jogged along successfully". Free trade was seen to give social movements much-needed breathing space by keeping civil society and the state apart.

The idea of the "citizen-consumer" encapsulated the new fusion of democratic ethics and mass politics. For many commentators today, this conjoined identity is an anachronism. As Andrew Marr put it recently in his vivid history of contemporary Britain, Britons have stopped voting and started shopping. By 2001, electoral turnout had dropped to 59% – it was slightly higher in 2005, but the percentage among first time-voters was a mere 37%.

It may be too simple to lay the blame for political disengagement at the doors of consumer culture; some affluent countries like Italy have very high voter turnout. What is historically interesting is how free trade managed to turn an appeal to consumers into a source of political mobilisation. Turnout shot up to an unrivalled 87% in the January 1910 election. How did they do it?

Partly, of course, free traders appealed to voters' material interests – cheap imports meant more food on the table, shoes for the kids, higher real wages. Importantly, however, this argument was not anchored in an idea of individual choice but in a social ethics of consumption. Free trade recognised the consumer as the public interest, Liberals such as the progressive thinker and journalist JA Hobson stressed. It was those who wanted to restrict trade who stood for selfishness and greed, symbolised by the American millionaire.

Ironically, then, free trade appealed as a bulwark against the selfish materialism with which it is often associated now. Under free trade, it was believed, consumers would cultivate a taste for higher goods and an ethical sensibility for the conditions under which goods were produced. Here was the core of an idea that recently has become attached to fair trade. Free trade, according to progressives, would create a new civic-minded person: a "citizen-consumer".

It would be dangerous to romanticise free trade. Poverty did not disappear. Free traders were not necessarily cosmopolitans. For most, free trade was a sign of Britain's civilising mission and superiority. Radicals caricatured protectionist Germany as a barbarian society of oppressed people reduced to eating horse sausages and dog-meat; David Lloyd George, the future prime minister, told audiences that he was not afraid of the Germany navy; he was afraid of the German sausage. Others believed in a free-trade British empire and its civilising mission. Conservative imperialists like Robert Cecil, the son of Lord Salisbury, even believed that free trade had successfully taken economic motives out of the empire altogether. Famines, poverty and exploitation disappeared from view.

Still, we cannot simply write off free trade as rhetoric to disguise the self-interest of a superpower. Many people genuinely did believe in free trade as a path to social inclusion, democracy and peace. These included people at the margins of society, workers, women, and children, who participated in demonstrations. Oral histories testify how the ethical dangers of taxing foreign goods, like sugar, were discussed by schoolchildren.

The growing role of mass communication

Ideas do not win by themselves, however. Chamberlain's tariff reform crusade mobilised an unprecedented army of agents and supporters. Free trade survived by stepping outside the economic textbook, using mass communication and entering a new terrain of commercial leisure, advertising and technology.

In the decade before the First World War, trade policy was fought out on the high street, in rural villages and on the beaches. In 1910, one free trade group alone organised over a thousand events in seaside resorts. Lecturers pulled visitors away from ice-cream vendors and minstrel singers, engaging them in talks about the life-and-death struggle for free trade. Processions and posters compared the big free-trade loaf of bread with the small loaf that symbolised the lower standard of living in protectionist countries. Nocturnal lantern lectures entertained rural audiences with cartoons of the large loaf versus the little loaf – "huge crowds watched them for hours in the rain".

Liberals turned the two loaves into an increasingly nationalist drama of British superiority. On high streets, free traders set up shop window displays that compared identical goods from Britain and protectionist Germany to illustrate the higher standard of living in Britain. In one London shop, the Liberal MP for north Camberwell, Thomas Macnamara, known for his "hard-hitting speeches spiced with good stories" and for having the "slimness and the energy of an athlete", even dressed up in flimsy German clothes.

Winston Churchill, who oversaw the campaign of one major free-trade organisation with characteristic military zeal, understood that communication and entertainment were vital. Statistics were not easily grasped by "the impatient man" of modern life. They needed to be set out in exciting contrasts, and in colour. By the January 1910 election, Liberals had covered the country with 660,000 colourful posters. Many contemporaries, in Britain and abroad, were fearful about the effect of "mass society" on political life, predicting that apathy or herd-like behaviour would undermine liberal politics. Like the liberal thinker Graham Wallas, Churchill and fellow free traders, by contrast, saw emotion as a source of political engagement, not its enemy.

This could lead to combinations that may look odd to readers today. In 1908, for example, audiences of a Chronomegaphone "Singing Pictures" show in Peckham had the pleasure of having "heated discussions" about trade policy on the floor while simultaneously enjoying "the Arab on his Steed singing his Bedouin Love Song … and several other more modern airs, among which were Zuyder Zee, and Waltz Me Round Again Willie". At the same time, it is a reminder not to presume that the rise of modern parties and consumer culture automatically saps political energy.

A post-war change of view

This democratic free trade culture began to unravel during and after the First World War. The war exposed the faith in the smooth workings of unilateral free trade as naive. Shortages, inflation and price cycles taught millions in the Co-operative movement that free trade could leave consumers defenceless. Conservative women, meanwhile, began to promote their own brand of ethical consumerism, urging housewives to buy empire goods to help their white brothers and sisters across the sea.

The war also exposed fundamental blind spots in liberal internationalism. Free trade had not guaranteed international peace and solidarity. The world consisted of states and organised business, as well as individual merchants and consumers. Economic globalisation had outpaced political institutions. Politics now needed to catch up. Inter-allied organisations had demonstrated the potential of new forms of international regulation during the war. After the war, new internationalists began to look to international agencies to co-ordinate trade, especially in politically explosive raw materials such as oil.

Conclusion

History does not offer a blueprint for the future. Still, it can give us a sense of perspective, locating current problems and developments in a longer time frame and alerting us to ways of thinking that have been neglected or lost altogether. For our current discussion about a future trade order, this earlier history raises two related implications.

First, current concerns about how to consume ethically have a longer prehistory. A century ago, it was to free trade that consumers looked to promote peace, justice and democracy. To draw a simple divide between economics and ethics is unhelpful. Free trade in the past did not win on the basis of sound economics but because it managed to speak to the hopes and passions of people. These included ambitions for citizenship, for social inclusion, and for an open trading order that treated strangers fairly and would advance international understanding. Free trade may not be ideal, but history suggests that the alternatives were often far worse, such as the economic imperialism and nationalism of the 1930s.

Second, that free trade is more than just economics has implications for the kind of political space and discourse in which trade is housed. Economists and political scientists (who have been increasingly informed by economic models) tend to look towards institutional solutions. The more democratic are institutions, the freer is trade, it has been argued on the basis of the experience of Latin and Central America in the last few decades. This is a very short-sighted and lopsided view. The democracy with the longest historical track record, the United States, has been heavily protectionist for most of its history. If subsidies and non-tariff barriers are taken into account, it would still count as protectionist in the eyes of Victorian Britons. In Britain, free trade was as much the cause of democratic politics as its effect.

The main conclusion here is not that economists and political scientists are bad historians. Rather, it is that seeing trade in institutional terms and looking for governance to international institutions staffed by experts has had the effect of extracting trade from its broader democratic home in civil society. Trade has become a technical subject, known, managed and governed by a specialised set of professions. It has a democratic deficit. The recent revival of interest in questions of fair trade and trade justice amply shows that most people care about trade and fairness. In thinking about a new world economic order, proponents of freer trade do well to reconnect trade to popular politics and older concerns about democracy, equity and peace.

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Chapter 4

A tale of two conferences – the International Trade Organization, GATT and world trade

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A tale of two conferences – the International Trade Organization, GATT and world trade

When the United States entered the Second World War, it was not only fighting to defeat Germany and Japan on land and sea: it also wished to defeat the economic errors of German bilateralism and British imperial preference that had marred the world economy in the 1930s. Indeed, the war was blamed upon these grievous departures from the true path of free trade and multilateralism. Cordell Hull, the US secretary of state, was a reincarnation of Richard Cobden and his belief that free trade would link the world in prosperity and peace. As far back as 1916, he argued that free trade was about internationalism rather than (as he earlier believed) cheap goods for American consumers:

[U]nhampered trade dovetailed with peace; high tariffs, trade barriers, and unfair competition, with war … if we could get a freer flow of trade … so that one country would not be deadly jealous of another and the living standards of all countries might rise, thereby eliminating the economic dissatisfaction that breeds war, we might have a reasonable chance of lasting peace.

In 1916, he proposed a post-war international trade conference to remove "destructive commercial controversies", and in 1917 Woodrow Wilson's Fourteen Points called for "the removal, so far as possible, of all economic barriers and the establishment of an equality of trade conditions among all the nations consenting to the peace and associating themselves for its maintenance".

Hull's ambitions were not fulfilled after the First World War. They had more chance of success during and after the Second World War, when he was in a position to influence policy. Might an International Trade Organization then be possible and might the US government use its undoubted economic and financial power to force Britain to abandon imperial preference and to oblige other countries to fall into line?

Not everyone was convinced by Hull's commitment to free trade. British scepticism was self-evident, and Keynes dismissed Hull's "lunatic proposals". Keynes's initial plans for post-war institutions stressed that Britain should retain its protectionist measures, and that anyone who abandoned them "would be as great a traitor to his country as if he were to sign away the British navy". Britain's serious balance of payments problem at the end of the war meant that an immediate return to free trade was impossible – though in principle a country so dependent on international trade had a strong commitment to the restoration of multilateral trade.

America and Britain's opposing views of the problem
If the Americans saw the problem of the 1930s as being the British adoption of imperial preference, the British were more inclined to see the problem as the very high level of tariffs adopted by the US with the Smoot-Hawley tariff of 1930. The British administration was therefore highly sceptical of American plans – and for their part, many US officials were equally critical of Hull's panaceas for the problems of the world.

Henry Morgenthau, the US secretary of the Treasury, complained that Hull was "obsessed by his trade agreements and … failed to realise that Japanese militarism and European fascism had released new and ugly forces which … could not be controlled politely". Cobdenism was not enough, for in the words of Harold Ickes, secretary of the interior, it was "like hunting an elephant in the jungle with a fly swatter". A pragmatic analysis of post-war realities might well collide with Hull's idealistic pursuit of free trade as a solution to the world's problems.

At Bretton Woods in 1944, forty-four nations signed the agreement that established the basis for the post-war international financial system. The deal arose from negotiations held between Britain and the US since 1942, to which other countries acceded without having an independent voice at the concluding conference. Despite the differences of approach between the Americans and British, the negotiations were highly technical, with a large degree of consensus between economists who had worked with the League of Nations on the currency problems of the 1930s.

The outcome was not a matter for partisan electoral politics. In the US, heated exchanges over bimetallism ended in 1896, and the Bretton Woods agreement was accepted as a means of containing destructive speculation. In Britain, currency issues were depoliticised by the Bank Charter Act 1844 and were only controversial at the time of the return to gold in 1925. In both countries, the deal of 1944 offered a balance between the benefits of monetary stability and a concern for domestic prosperity.

Trade policies were a very different matter, for debates over free trade and protection had been central to politics in both the US and Britain for over a century, setting Democrats against Republicans and South versus North in the US, and splitting parties and losing elections in Britain. Hence discussions over the post-war order were deeply contested and took much longer to resolve.

After a number of preparatory meetings to create the framework for discussion, two major conferences were held at Geneva and Havana in 1947-48. Although Britain and the US took the lead in preparing the way, they were more divided in their views than over monetary policy. The British government was deeply hostile to the assumptions of the American negotiators that they disband the preferences given to empire goods, and political opinion within the US was also sharply divided between committed free traders and protectionists.

Unlike in 1944, other countries could not be excluded from expressing their views and inserting their own ambitions into the discussion. Consequently, the two conferences at Geneva and above all at Havana brought two considerations into tension: effectiveness, which entailed incorporating as many nations as possible in the agreement; and equity, where a larger number of participants inserted competing notions of fairness in the economic relationships between nations. The result was to overburden discussions at Havana, leading to the failure of the International Trade Organization. In the end, effectiveness rested less on widening the number of participants than on a pragmatic narrowing of issues to the General Agreement on Tariffs & Trade.

Grand statements and bold ambitions

In 1945, the Americans set out their *Proposals for Consideration by an International Conference of Trade & Employment*, which aimed to do what had not been possible after the First World War. The proposals started with a grand statement that collective measures designed to safeguard peace must be based not only on machinery to deal with disputes but on "economic co-operation among nations with the object of preventing and removing economic and social maladjustments, of achieving fairness and equity in economic relations between states, and of raising the level of economic well-being among all peoples". The foundation of such a policy was "the attainment of approximately full employment by the major industrial and trading nations", which was:

... essential to the expansion of international trade on which the full prosperity of these and other nations depends; to the full realization of the objectives of all liberal international agreements in such fields as commercial policy, commodity problems, restrictive business practices, monetary stabilization, and investment; and, therefore, to the preservation of world peace and security.

One country's pursuit of full employment should not be at the expense of creating unemployment elsewhere, as happened in the "beggar-my-neighbour" policies of the 1930s when protective duties to preserve jobs led to a decline in world trade and hence to a decline in economic activity as a whole. The pursuit of full employment in every country should be complemented by measures to promote the growth of international trade.

The difficulties of achieving these bold ambitions were immediately apparent, for the proposals appeared on the same day that America made a loan to Britain. The British were the main allies of America in the plans to reconstruct the post-war international economy, but their attitudes diverged. The loan was intended, as Clement Attlee informed the House of Commons:

... to assist the United Kingdom to assume the obligations of multilateral trade. This credit would make it possible for the United Kingdom to relax import and exchange controls ... and generally to move forward with the United States and other countries towards the common objective of expanded multilateral trade.

But Attlee had little intention of giving up imperial preference, despite the obligation both of the Lend-Lease agreement of 1942 and the loan of 1945, and he was acutely aware of Britain's serious balance of payments deficit. He stressed the need to control imports so long as necessary to restore the balance of payments. Moreover, multilateralism could not be a one-way process of Britain surrendering its preferences; the Americans needed to open their own markets by reducing tariffs. From the start, therefore, negotiations were marked by mutual incomprehension.

Conflicting ideas of full employment – a snark or a boojum?

A pledge to full employment was itself open to misunderstanding. The British plans on full employment were elaborated by James Meade, who wished to stabilise world demand through buffer stocks for primary products, an international public works programme, international loans for capital development, synchronisation of national credit policies, and an obligation by all countries – and above all the US, whose economy would have such a huge effect on the rest of the world – to maintain domestic employment. The aim of the British government was to make acceptance of an international convention of employment a condition of membership of the ITO.

Not everyone was convinced. One leading critics was PJ Grigg, the British executive director to the International Bank of Reconstruction & Development, who warned of the "untimeousness" [sic] of such a policy. He argued that it was "chimerical ... unless there is a much greater abandonment of national sovereignty than now looks probable". He feared that the bank would "react very strongly against any suggestion that it shall be big-brothered in its day to day work" by the Economic and Social Council of the United Nations. The result, he feared, would be to wreck the new bank by making it run before it could walk or even toddle. And would the plans really prevent a serious depression in the US, even if the administration was willing to accept the commitment?

However, RWB Clarke of the British Treasury felt that the policy was crucial for Britain. In his view, a commitment to the ITO would probably increase unemployment and make the British economy still more dependent on exports than in the 1930s, with a greater threat from:

… the highly peripatetic US economy … We are, in fact, embarking upon a high import-high export policy with no safeguards at all about the stability in USA and with very limited powers to take protective action in co-operation with like-minded countries to ease the impact of US depression on our economy.

The British government feared that the US was peculiarly liable to boom and bust, to economic instability that would spill over to the rest of the world. The choice was simple: either international institutions needed to work on the basis of full employment, or the ITO policy of high imports and high exports should be modified. Clarke's colleague at the Treasury, SD Waley, concluded that Meade's scheme was "perhaps a bit on the theoretical and utopian side, but on the whole it seems to me to be good socialism and good sense".

Indeed, it offered a means of combining two elements of Labour policy that were otherwise in tension and have proved problematic for progressive trade policy ever since: a commitment to domestic planning and to multilateral trade. The British government accordingly took the lead in developing an international convention with the intention of "showing that a free society can engage in sufficient economic planning to prevent serious economic depression".

A number of countries supported the British scheme, but problems soon arose. Full employment was open to many interpretations: as useful employment for all able and willing to work; avoidance of under-employment and sweating; or even the right to a dignified existence. Whether any of these initiatives and definitions was acceptable to the US was very doubtful. After all, the progressive Full Employment Bill 1946 was rejected, with its ambition of providing "such volume of Federal investment and expenditure as may be needed … to assure continuing full employment". Here, it seemed to its critics, was a step towards socialism, or at least a threat to the flexibility of a free-market economy and a danger of inflation. The Employment Act 1946 was much more modest, and Americans were deeply suspicious of attempts to insert the ideas through the ITO.

Grigg was close to the mark when he alluded to the nonsense poem of Lewis Carroll: "full employment is not a snark but a boojum". Carroll warned of the dangers of hunting a snark: if it turned out to be a boojum, "you will softly and suddenly vanish away, and never be met with again".

The birth of GATT and struggles towards an ITO

Detailed discussion over the path to multilateral trade started in 1947 at Geneva, where 23 countries that were responsible for 80% of world trade negotiated the General Agreement on Tariffs & Trade. The US administration welcomed GATT as "the most comprehensive international instrument ever negotiated for the reduction of barriers to international trade". The Americans cut their tariffs on average by 35%, and replaced the existing bilateral deals with individual countries by most-favoured-nation agreements so that a concession to one country was generalised to all others.

These concessions could be made by presidential action through the Reciprocal Trade Agreements Act 1934 (RTAA), by which Congress delegated powers to enter into bilateral agreements to reduce tariffs by 50%, and to apply them to other countries through most-favoured-nation agreements. Generally, presidents are likely to prefer lower tariffs, for they are less reliant than members of Congress on support from particular local interests. Delegation to the president meant that log rolling in Congress was largely eliminated. The RTAA institutionalised trade liberalisation before it was generally accepted, excluding interest groups that were hostile; wider support became possible after it seemed to deliver growth.

As well as negotiating GATT, the delegates at Geneva drew up a draft charter for the ITO, which was to be discussed at a second conference at Havana between November 1947 and March 1948. The chief US negotiator at Havana, assistant secretary of state Will Clayton, was steeped in the notions of Hullism and the redemptive powers of free trade. Harold Wilson, one of the British ministers involved in the negotiations, was exasperated by Clayton's stance at Geneva, complaining that he was "nice and well-intentioned but woolly in his mental processes and dominated by rigid conceptions held in a sort of self-righteous haze" so that his interventions "often seemed like discourses on points of theological dogma or morality". Clayton set out his ambitions for the ITO charter in grandiose terms:

Without it, nationalism would rule in the economic and political world, shattering our hopes for a prosperous and peaceful world. Between world wars I and II, nations had acted unilaterally in international economic affairs. Such action would benefit a nation only until other nations took similar action. In the end, all countries had been hurt and embittered ... a charter for organizing the world effectively for international economic co-operation was urgently needed, as otherwise all efforts would prove futile; restored productivity would again bring unmarketable surpluses and starvation prices; any aid provided would be a mere palliative ... The decisions taken in Havana would certainly fix the pattern of international trade for many years to come. There were only two roads *open to the world, one leading to multilateral, non-discriminatory trade with a great increase in the production, distribution and consumption of goods and happier relationships between all countries; the other leading to economic nationalism, bilateralism, discriminatory practices, a lowering of the standard of living and bad feeling all around. It was up to this Conference to choose which road to take.*

Such idealistic, even naive, enthusiasm soon encountered reality.

At the Geneva conference, representatives of the underdeveloped world demanded quantitative restrictions and preferences between neighbouring states which were clearly inconsistent with multilateral trade. They did not make much progress at Geneva, for the conference was dominated by developed countries. The American line at Geneva was that voting rights should be limited to full members of the United Nations, and this view was upheld by the Economic and Social Committee of the UN. The British government was critical, arguing that the limitation rested on the "completely misconceived idea that the prestige of the United Nations depended on exclusivity rather than on the successes it achieves".

Of course, votes in the UN on security and general political issues were necessarily confined to members. In the case of functional specialised agencies, however, the issue was effectiveness, which meant including the greatest possible number of countries in the particular field. This principle already applied to the International Labour Organization and the Food & Agriculture Organization. The British argued that everyone invited to Havana should have a vote or they would be prejudiced against the scheme. The ITO charter would affect the economy and trade of everyone, and would arouse opposition. It was therefore essential that governments should be able to show their parliament and public opinion that they were able to present their point of view and, above all, vote.

Indeed, this realisation applied with considerable force to the British themselves. As the British representatives explained:

... in the present state of the world a comprehensive International Trade Organization is more important than the securing of a Charter with only limited adherence but which safeguards our [British] and their [American] position more effectively.

A bigger role for developing countries

In the end, the British won the argument and every country was allowed to vote. However, the Americans then went much further than the British had wished, abandoning the initial proposal that voting should be weighted by trade, and substituting a franchise of one country, one vote. Rather than expressing gratitude, as was naively assumed, the majority of undeveloped countries instead pressed for greater concessions. The balance of power changed in favour of the underdeveloped countries.

The underdeveloped countries took it as axiomatic that the Genevan text of the ITO charter was heavily weighted in favour of the "big commercial countries". In particular, the Latin American countries played a crucial role. They were concerned that America was turning its attention to the reconstruction of Europe through the Marshall Plan. The Canadian report on the Havana conference reported the fears of the Latin American delegates:

… the fairy godmother of the North was deserting them in favour of Europe. Their acquaintance with socialist ideas had converted them to a form of international socialism in which the richer countries were under an obligation to the poorer countries to promote the economic development of these countries and to raise their standard of living up to that of the richer countries.

During the war, new industries developed in Latin America as a result of a reduction in imports from the US and Europe. Once the war was over, Latin Americans feared the revival of European competition. Their aim was to maintain quantitative restrictions and preferential arrangements to encourage development within Latin America, based on economic integration and import-substituting industrialisation. Their approach was clearly expressed at Havana by the representative of Venezuela:

The equality embodied in the Charter must not be of the nineteenth-century type, which actually established disequality [sic] by making it impossible, for instance, for Latin American Countries to develop new economies. During that period they had furnished raw materials and had been a dumping ground for finished products. This had now been substituted by the just idea of economic interdependence for the welfare of all. A Charter would not be possible unless the old prejudices were discarded and instead modern dynamic principles of co-operation adopted.

Such a developmental approach clearly complicated Hull's and Clayton's panacea of multilateralism as a solution to the economic problems of the world.

One concession granted to the developing countries was protective or development quotas designed to restrict imports in order to support infant industries. The Americans opposed any such concession at Geneva but gave way at Havana. The second concession was the right to introduce new preferences. At Geneva, no new preferences were allowed unless a two-thirds majority of the ITO agreed that they were needed for economic development. At Havana, new preferences could be introduced provided they were within the same economic region and were needed for development.

Since Britain was committed to ending its own preferences by the terms of Lend-Lease and the loan of 1945, there was an obvious inequity if other countries were able to introduce new preferences at the expense of British export markets. The issue was finally resolved by inserting a footnote to the effect that an economic region could be defined in terms of integration as well as proximity – a definition that covered the British empire. Hence Commonwealth preferences could be preserved.

Protectionist sentiment in America grows

While Clayton was busy pursuing multilateralism at Havana, domestic opposition was becoming apparent. The RTAA was one thing: the ITO charter was quite another matter. Warning signs were apparent in 1947 when Clayton's negotiation of tariff reductions at Geneva coincided with Congressional discussion of protection of American wool growers. The administration feared that any such measure would be seen as a turn to isolationism and would "scuttle" discussions at Geneva. The bill split the Senate foreign policy team: Arthur Vandenberg (chairman of the foreign relations committee of the Senate in 1947-48 and a recent convert from isolationism) voted against the bill; John Connally, later to be Nixon's secretary of the Treasury, voted for protection. The bill was, in the end, vetoed by President Truman.

More significantly, Congress did not ratify the ITO, which fell foul simultaneously of the "perfectionists" who felt it was insufficiently committed to free trade and of the "protectionists" who felt that it surrendered too much. Although the Americans did not retreat into isolationism, as the British feared, the grand ambitions of Hull and Clayton were frustrated. US policy turned away from the pursuit of multilateralism and convertibility to a more gradual and realistic programme that took greater account of the problems of reconstruction in Europe.

Even at Geneva, Clayton had been willing to accept customs unions – a position considered "completely illogical" by the British. Indeed, regionalism is now seen as a potentially serious threat to multilateralism, whereas less than full reciprocity has co-existed with the most-favoured-nation principle in GATT without serious problems. However, after the war a customs union in Europe, unlike imperial preference in the British empire, could be seen as a step away from bilateralism to freer trade in a multilateral world.

The Americans thus moved from pure multilateralism to an intermediate phase of widening trade between countries, in conjunction with the European Payments Union.

Idealism was moderated by pragmatism. Above all, the ITO charter had become over-burdened with conflicting and unrealisable ambitions, and the more limited scope of the GATT was more realistic. The failure of the ITO and survival of GATT was, in the words of a recent commentator:

… a blessing in disguise: with a multifaceted agenda ranging from restrictive business practices to intergovernmental commodity agreements, the ITO risked evolving into a large bureaucracy that would have institutionalized and sanctioned state regulation of international commerce as much as it would have freed trade from such controls … The narrow focus of the GATT served the process of trade liberalization … well because the GATT's mission was simple and straightforward. The GATT had no autonomous power, independent leverage, or financial sanction. The GATT, in some sense, did not exist beyond the commitment of its members … to reach certain goals through a negotiated consensus.

By the time of the trade rounds of 1949 and 1950-51, the president had little remaining authority. In the words of John W Evans, "where negotiations were with existing contracting parties … most of the available coin that could be used without serious political cost had already been spent". This erosion of presidential discretion meant that progress in subsequent rounds at Annecy (1949) and Torquay (1950-51) was slight. What GATT did achieve was the preservation of the gains of 1947. By forgoing the right under article 28 to revoke tariff concessions in negotiations with the principal suppliers of any commodity, GATT created a "lock-in feature". Meanwhile, trade liberalisation proceeded in Europe through the customs union, which the US accepted as a step towards recovery and multilateralism.

Of course, there was a danger that when the European Economic Community was created in 1958 it would become a closed trade bloc with high external tariffs. Further, the EEC was economically more successful than the US. Between 1958 and 1960, the EEC gained $6.5bn in reserves; the US lost $4.7bn, and the US balance of payments was weakening as Europe achieved surpluses. Growing concern that the EEC would be a protective bloc meant that a special effort was needed to reduce trade barriers. The issue came to a head with the British application to join the EEC in July 1961: there was a danger that Britain would be infected with protectionism but also a chance that it would be a Trojan horse of liberalisation to minimise the role of France (which was exactly what De Gaulle feared).

Soon after the British application, Kennedy launched a successful campaign to secure more powers for trade negotiations through the Trade Expansion Act 1962 (TEA), which authorised him to reduce tariffs by up to 50%. Congressional and domestic involvement was again limited. Unlike in 1934, the president had complete freedom of action on the techniques to be used. Expectations were high. In Kennedy's words in the state of the union address in January 1962, the measure "could well affect the unity of the West, the course of the Cold War, and the economic growth of our nation for a generation to come".

The negotiations of the Kennedy round became deadlocked and the powers of the TEA were due to expire on 30 June 1967. The problem partly arose within the EEC with debates over the relative powers of the Council of Ministers (representing government ministers from the member states) and the Commission (of European bureaucrats). In any case, the EEC was more concerned about the rapid growth of internal trade than external trade liberalisation, and was wary about including agriculture until its own agricultural policy had been determined. Further, President Johnson and his immediate advisers were more concerned with Vietnam.

Agreement was finally reached at the very last moment on the day the TEA was due to expire. Unlike at Doha, the deadlock was broken because negotiations were dominated by trade rather than by a wider development agenda, which was largely left to the United Nations Conference on Trade and Development (UNCTAD). Furthermore, the negotiations were dominated by two partners – the US and the EEC – whose common interests in defence and security mitigated tensions over trade. In the words of President Johnson, it was "the most successful multilateral agreement on tariff reduction ever negotiated".

Not everyone was convinced. Although the Kennedy round struck a deal with the EEC, which was the main aim of the US negotiators, Japan made no concessions. Between 1965 and 1967, US imports from Japan exceeded exports by 17%; between 1975 and 1977, the figure was 50%. Developing countries also secured access to US markets without opening their own economies – a partial concession to the agenda of UNCTAD.

Alexander Trowbridge, the US secretary of commerce, remarked that the "American domestic market – the greatest and most lucrative market in the world – is no longer the private preserve of the American businessman". The US trade surplus continued to weaken, and the balance of payments deficit to increase. Not surprisingly, there was a backlash. Industries facing threats from imports were able to mobilise and maintain protection, in part through non-tariff trade barriers. Internal voices for protection started to increase, and the ability to insulate multilateral trade negotiations from domestic considerations was weakened.

Tension between effectiveness and equity

The two conferences at Geneva and Havana illustrate a fundamental tension in trade negotiations between effectiveness and equity. The creation of GATT at Geneva was able to deliver considerable gains in reducing trade barriers, yet at the expense of excluding or marginalising the voice of less developed countries which felt that there were much wider issues at stake than the mere reduction of tariffs and elimination of preferences. However, the insertion of these larger concerns of full employment and of fairness in world economic relations overloaded the discussions and alienated Congress. GATT proved to be more practical and successful than the putative ITO.

But this is not to say that issues of morality and justice were excluded: the US proponents of multilateral trade had a very clear sense of the benefits of free trade in producing prosperity, peace and justice. The British with their concern for international policies of full employment as a precondition for free trade, and the less developed countries with their concern for a redefinition of trade relations between rich and poor countries, had their own competing moralities. By avoiding some of these clashes of normative assumptions, GATT achieved some practical success in the short and medium term. Whether they could be avoided in the longer term was much more doubtful.

Does this tale of the two conferences at Geneva and Havana offer lessons for the collapse of the Doha Development Agenda? One possible moral is that broader developmental aims should be left to other domains of policy, as eventually occurred through UNCTAD and other initiatives, and that trade policy should be kept distinct to avoid the danger of so overloading discussion that agreement proved impossible.

The attempt to widen participation at Havana was designed to make discussion more open and to secure the legitimacy and effectiveness of any agreement. In practice, the result was to bring fundamental issues of equity into play. Could freer trade be fair unless action were taken to deal with unemployment through measures designed to stabilise the world economy? Might dependence on US markets make exporters susceptible to the volatility of its economy? Should measures be adopted to improve the position of primary producers, and the international economy stabilised through co-ordinated public works? These wider issues so overburdened the negotiations at Havana that the ITO charter failed, leaving the way for more realistic and pragmatic solutions through GATT.

One lesson from Havana is that it is dangerous to insert development issues into the WTO – although it is obviously more difficult in 2009 to ignore fairness and equity, given that the WTO has 153 members, compared with 23 signatories of GATT. Issues of process are critical, as was recognised after the war with the discussion of voting rights at Havana. The British saw that wider membership was vital for legitimacy, with the danger that highly contested notions of development might lead to deadlock. Wider membership required a degree of segmentation so that agreement could be reached on each individual issue.

The lesson has not been learned in Gordon Brown's proposals in the immediate aftermath of the financial crisis in October 2008 for a new Bretton Woods to cover both the international financial system and trade. Even in the Second World War, both issues were kept separate. Financial reform was only possible because two major powers could reach agreement, building on expert consensus, and impose their terms on the rest of the world. At present, agreement on financial reform is unlikely, for there is no expert consensus on whether regulation will cure instability or lead to moral hazard. The US is no longer able to provide leadership as in 1944, and is arguably the cause of the difficulties – and China is not able to flex its financial power.

The circumstances are therefore less propitious than in 1944 for solving issues of financial stability – and can scarcely be improved by combining with trade. Although Brown seems to assume that the financial crisis provides the incentive to unblock the deadlock at Doha, it is more plausible to think that combining the two issues will lead to greater problems. If there was one lesson from the experience between 1944 and 1948, it was that compartmentalisation between finance and trade, and between trade and development, made more sense than a vain hope for a comprehensive settlement.

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Chapter 5

Reforming the multilateral trading system – lessons of the Doha negotiations

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Reforming the multilateral trading system – lessons of the Doha negotiations

The Doha Development Agenda – the ninth round of multilateral trade negotiations if we take into account the history of the General Agreement on Tariffs & Trade, but the very first since the establishment of the World Trade Organization in 1995 – was launched in November 2001. It was scheduled for completion in 2005 but negotiations have repeatedly deadlocked. They suffered another blow in the latest round of trade talks in July 2008, leading director general Pascal Lamy to announce on 20 July: "It is no use beating around the bush. This meeting has collapsed. Members have not been able to bridge their differences."[1] All members agree that the round is still worth fighting for, but they are divided on the ways in which this might be achieved or what the next steps should be.

The repeated failure of negotiators to reach agreement on the Doha Development Agenda, or DDA, generates huge costs. Lamy, addressing the Trade Negotiations Committee on 29 July 2008, was right: "What members have let slip through their fingers is a package worth more than $130 billion in tariff saving annually by the end of the implementation period, with $35 billion saving in agriculture and $95 billion in industrial goods."[2] But the gains from the round must be assessed not only in terms of its immediate impact but also in terms of the insurance – via tariff bindings – that a completed round would provide against the risk of increasing protectionism.[3] In the current financial climate, the costs of protectionism could be catastrophic.

Demands for protectionism against both trade and migration have been on the rise in the West, and are bound to increase if recession deepens. Had governments agreed to a Doha deal in accordance with the schedule, they would have been able to resist these calls for protectionism. But without a Doha agreement, the difference in the bound versus applied tariff rates on industrial products and the legality of agricultural subsidies mean that countries will be able to raise barriers against imports with relative ease. If protectionism does rise, the effects of this financial crisis will translate very dramatically and adversely into the production sectors and trade of developing countries. Recovery from a crisis of such global proportions would be even more slow and painful.

While the multilateral trade process has stagnated, scholarship on the subject has not. The rich repertoire of scholarship that has emerged can be grouped broadly into two sets.

1 www.wto.org
2 http://www.wto.org/english/news_e/news08_e/meet08_summary_29july_e.htm, accessed on 15 October 2008
3 Patrick Messerlin "A Doha Deal Would Aid Many European Farmers" in *Financial Times*, 21 July 2008

To the first set belong papers that focus on the specific deals that underlie the negotiations and the gains to be realised from them, and point to ways in which the deadlock can be broken. In contrast, to the second group belong works that choose to bypass the quagmire that has become the DDA, and instead focus on broader questions of institutional reform. Both sets of enquiries are intellectually interesting, but limited from a policy perspective.

To get bogged down entirely in the details of the substance of the negotiations, and debate over the balance of potential gains and losses, is to risk missing the forest for the trees. After all, the WTO fulfils several other functions besides facilitating the current round of trade negotiations. These include the certainty and systemic stability that come from having an established system of rules governing trade relations, and a powerful dispute-settlement mechanism to implement those rules.

On the other hand, to focus exclusively on longer-term institutional reform seems somewhat of an indulgence at a time when the most immediate tasks facing the WTO have gone so awry, and when the inability of the organisation to deliver results through the DDA has exacerbated political disengagement from the multilateral trading system. The missed deadlines and declining ambition of the Doha negotiations cannot simply be brushed under the carpet. Disillusioned stakeholders of the organisation will not welcome grand projects of institutional redesign when their latest investments (in the form of negotiation costs of the DDA) have not paid off.

The limitations of both these sets of analyses can be partly overcome by posing the puzzle that links them: what are the lessons of the last seven years of negotiating the DDA, and do they offer us any insights into directions that institutional reform might take? In this paper, I focus on this question, and find that the delays and failures of the DDA negotiations shed light on three broad sets of problems:

- the substance of multilateral trade governance;
- the process of trade negotiations in the WTO; and
- the normative underpinnings of the multilateral trading system.

The lessons of Doha for each of these areas – for resolving the Doha deadlocks as well as reforming the institution – are discussed below. Based on this analysis, the concluding section presents a set of policy recommendations for reform. Finding a solution to the Doha deadlock, and to the institutional problems that underlie it, acquires unprecedented urgency in the context of the financial crisis. A timely Doha deal could have avoided the risks of spiralling protectionism in tough economic times; a belated Doha agreement could still help to mitigate some of the worst effects of the financial crisis.

The substance of multilateral trade governance

The ease with which parties can negotiate a trade round depends to a great extent on the agenda and what is included. Nor is scale of ambition necessarily a deterrent to agreement: more items to negotiate can sometimes create positive issue linkages and make it easier to bring a large number of diverse countries – and interests and lobbies within them – on board. But much depends on the package that is being negotiated.

For instance, the last round of trade negotiations – the Uruguay round – took significantly longer to negotiate than earlier ones, given that it also took the GATT into the new and controversial areas of TRIPs (the agreement on trade-related aspects of intellectual property rights), TRIMs (trade-related investment measures), and services, as well as the old but highly contested areas of agriculture and textiles.

The scope of the DDA, when it was launched, was wider still. This width of scope may have potentially offered a greater likelihood of both developed and developing countries signing up to a new deal, but it also came with two unanticipated problems.

First, while the intention of the negotiators to integrate developing countries into the multilateral trading system was commendable, the naming of the new round, as the Doha *Development* Agenda, and its accompanying commitment to development has turned out to be more of a mixed blessing. On the one hand, given the claims by developing countries about their decades of marginalisation from the GATT and the WTO, and their complaints about the inadequate returns generated from the Uruguay round because of problems in implementation, a commitment to development matters seemed like a useful device to bring the disenfranchised and disgruntled members of the WTO on board. It also helped to quell some of the critiques with which NGOs had been lambasting the WTO.

But these gains came at a cost. Giving the label of development to the new round changed the focus of trade negotiations to something less quantifiable. Above all, it created far-reaching expectations from larger developing countries NGOs. Sylvia Ostry's comment on the overzealous proponents of free trade and globalisation creating unrealistic expectations is perhaps even more true for the tantalising promises of the DDA: "If you promise but can't deliver Nirvana, it's bound to evoke cries of Armageddon from the disapproving and the disappointed."[4]

4 Sylvia Ostry "Global Integration: Currents and Counter-Currents", Walter Gordon lecture at the University of Toronto, 23 May 2001 (http://www.utoronto.ca/cis/ostry/docs_pdf/GlobalIntegration.pdf, accessed on 8 May 2008)

Not only does the explicit inclusion of development into the round bind the WTO to goals that could potentially take it significantly beyond trade, but the development-related goals embodied in the *Doha Ministerial Declaration* are further vague enough to allow a range of interpretations. These varied interpretations are not necessarily compatible with each other, or even with the broader goal of multilateral trade liberalisation. The shape that the development components of the DDA have taken means that the organisation risks running into a host of problems relating to mission creep, akin to those in which the World Bank finds itself entrenched.

Finally, the commitment to development concerns may have contributed to a perception in developed countries – particularly business interests within them – that the round's driving mechanism is charity rather than reciprocity, and offers them few gains. This perception – or rather misperception – may partly help explain the disengagement of business from the DDA, in contrast with the significant role that certain business groups in the North played in the launch of the Uruguay round and its conclusion.

The last point brings us to the second problem generated by its mandate: development was not the only direction in which the scope of the WTO has expanded with the launch of the DDA. Some attention also had to be paid to the interests of developed countries. As a result, environment was included as part of the work programme, and also the four Singapore issues of trade and investment, transparency in government procurement, competition policy, and trade facilitation. But the resistance of developing countries to the inclusion of these issues, particularly the Singapore issues, ended up creating more problems than solutions.

The immediate cause for the deadlock at the Cancun ministerial conference was disagreement over the Singapore issues. In the end, as part of the compromise reached in the July Package of 2004, three of the four issues were taken off the agenda. The fourth issue – trade facilitation – was retained in the DDA negotiations, but in a watered-down form: it was recognised that "the extent and the timing of entering into commitments shall be related to the implementation capacities of developing and least-developed Members".[5]

Together, these two problems have meant that the DDA negotiations have created unrealistic expectations on the part of developing countries, while fostering an unwillingness among developing countries to make concessions on anything that they perceive as interfering with the promise of development. Additionally, even though there exists a positive zone of agreement where gains are to be had by both developed and

5 July Package 2004: *Annex D, Modalities for Negotiation on Trade Facilitation*, paragraph 1 (http://www.wto.org/english/tratop_e/dda_e/draft_text_gc_dg_31july04_e.htm, accessed on 4 May 2008)

developing countries, the fraught history of the Singapore issues has further contributed to the disengagement of pro-liberalisation domestic lobby groups in developed countries from the new round.

Both these sets of problems could have been partly avoided by a more moderate assurance of development and by a greater focus on the gains to be reaped through trade liberalisation in agriculture, non-agricultural market access, services, and other issue areas. The acrimony surrounding the Singapore issues, and the legacy of distrust that it has left behind, could have been considerably reduced had the process of trade negotiations been better handled.

The process of trade negotiations

The problems created by the informality of the negotiation process and ad hoc, improvised solutions were most patently manifest in the debate over the Singapore issues at the Cancun ministerial conference.[6] As a concession to developing countries, the *Doha Ministerial Declaration* had stated that negotiations on the Singapore issues would start in the next ministerial conference "on the basis of a decision to be taken by explicit consensus, at that session on modalities of negotiation".[7] The problem arose from the fact that the developing country interpretation of "explicit consensus" differed from the developed country one.

The conflict at Cancun on the Singapore issues was rooted in these divergent interpretations. The stalemate over these was not broken until July 2004. Besides creating substantive hurdles to reaching agreement, these events further contributed to the levels of distrust between the North and South. Developing countries in particular perceived the conflict over interpretations as the absence of due process. The loss of time, loss of face (for developed countries, which had finally to give up on their attempt to include the Singapore issues in the DDA), and a further loss of trust could all have been avoided had clearer institutional mechanisms been in place to avoid the ambiguous interpretations.

Informal decision-making processes are not new to the WTO; indeed, they constitute one of the many features that the WTO inherited from the GATT. These informal processes worked in the GATT in so far as developing countries were happy to sit on the periphery of the "Rich Man's Club" and gain the benefits of free-riding on the principal supplier principle via the provision of the most-favored-nation status that was conferred on all the contracting parties. Decisions could be arrived at with relative speed and efficiency in Green Room meetings, from which most developing countries were excluded. But the

6 Narlikar, A *The World Trade Organization: A Very Short Introduction* (Oxford University Press, 2005)
7 *Doha Ministerial Declaration* (November 2001), paragraphs 20, 23, 26, and 27
(http://www.wto.org/English/thewto_e/minist_e/min01_e/mindecl_e.htmm, accessed on 5 May 2008)

limitations of informal decision-making processes in a member-driven organisation have come to the fore in the DDA negotiations.

First, the DDA negotiations involve an expanded membership (now numbering 153 members), and a much larger group of countries that are no longer willing to remain passive or marginalised. With a lot more to play for in the DDA, not only have larger and smaller developing countries found a bigger voice to fight with, but smaller countries too have mobilised in coalitions to push for their agenda. These developments are to be welcomed in so far as they bear potential for increasing the sense of ownership that all members can come to acquire for the WTO. But, inevitably, the problems of building consensus have multiplied several times over, as larger numbers of countries, representing highly divergent interests – from small economies and larger developing countries on the one hand to OECD countries on the other – have begun to exercise their voice.

Second, and contrary to the pessimistic predictions by some scholars, the WTO has actually been responsive to the proactive bargaining by developing countries. Some of the attempts to improve internal transparency and make decision making more inclusive date back to the aftermath of the Seattle ministerial conference. They also find reference in the Doha Ministerial Declaration. But more recently, and even more concretely, the entry of developing countries to the high table of trade bargaining is reflected in the replacement of the old "Quad" (which used to comprise Canada, the EU, Japan and the US) by a new group of four comprising Brazil, India, the EU and the US.

While these developments have made WTO decision-making processes more representative in membership and more transparent, they have also resulted in a more confused medley of divergent voices, cheap talk and posturing. The relatively more inclusive Doha process is also one wherein it is much harder for negotiators to arrive at agreement with speed and efficiency.

Normative considerations: the limits of fairness?

Despite the problems in the substance of the DDA and the limitations of the Doha process, one development stands out: the DDA is unprecedented in the attention that it pays to the role of fairness in the negotiations, in terms of both process and outcomes.[8]

The attempt by the WTO to address the issue of fair process is borne out in the reforms

8 The distinction between fairness of process and fairness of outcomes is drawn from Franck, T *Fairness in International Law & Institutions* (Clarendon Press, 1995). Franck writes: "… fairness is a composite of two independent variables: legitimacy and distributive justice" (p26). Franck further associates concerns over legitimacy with concerns over procedural matters, and the concerns over distributive justice with equity in outcomes.

undertaken post-Seattle to improve internal transparency. The *Doha Ministerial Declaration* takes these attempts further, for instance in paragraph 10, which makes reference to improving "internal transparency and the effective participation of all members". Most concretely, equal opportunity in the process of trade negotiations has been reflected in the demonstrated ability of coalitions of developing countries to hold up the round until their demands are met. Further, while some countries (such as Brazil and India) have a long history of active participation in the GATT and the WTO, the Doha negotiations stand out in the visibility and proactive mobilisation of smaller developing countries (as well as larger developing countries), individually and in coalitions.

The DDA pays unprecedented attention to the long-standing demand of developing countries on fairness of outcomes. This is reflected partly in the attempt to bring development concerns into the mainstream of the negotiation. For instance, paragraph 2 of the *Doha Ministerial Declaration* states:

... we shall continue to make positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development. In this context, enhanced market access, balanced rules, and well targeted, sustainably financed technical assistance and capacity-building programmes have important roles to play.

It is also worth recalling that though special and differential treatment (SDT) provisions were considerably watered down with the creation of the WTO, the DDA renews the organisation's commitment to them. For instance, paragraph 44 of the *Doha Ministerial Declaration* states: "We reaffirm that provisions for special and differential treatment are an integral part of the WTO Agreements" and further, "... all special and differential treatment provisions shall be reviewed with a view to strengthening them ...".

These attempts to improve the fairness of process and outcomes in the WTO are not to be scoffed at. Interestingly, however, they have not contributed to an increase in the legitimacy of the organisation. The reason for this is that fairness comprises only one component of the notion of legitimacy; the other key component that bestows an institution with "the right to rule" is efficiency.[9] Unfortunately, partly because of the problems highlighted in the last two sections relating to agenda and process, the efficiency of the institution has actually declined.

9 This notion of legitimacy as comprising two components, fairness and efficiency, was developed in: Narlikar, A *Legitimacy of the International Economic Institutions*, paper presented at the conference Global Exchanges: The Philosophy and Practice of the Global Political Economy on 6 September 2007 at the Institute of Philosophy of the University of London

Additionally, improvements in the fairness of process and outcomes have also taken a toll on the organisation's efficiency. Consultations with a larger number of countries, voice to a very diverse set of members, and outcomes that satisfy both the strongest and the weakest, while all improvements on the status quo ante, contribute to the problems of delay and deadlock.

Even prior to the DDA, the source of the WTO's legitimacy deficit was rooted in decision-making processes that were seen to be unfair and outcomes that were seen to be unbalanced by the developing world. Today, the WTO's legitimacy deficit is rooted in the perception that its laboured decision making and development-friendly negotiations have rendered it inefficient and ineffective in negotiating deals of consequence to the developed world. Until the balance between fairness and efficiency considerations is renegotiated, the legitimacy of the WTO will continue to be under challenge.

Conclusion – policy recommendations

In this paper, I have identified some of the immediate as well as longer-term problems that the Doha negotiations have revealed. What follows below is a set of policy prescriptions for institutional reform that emerge from the discussion in the previous pages.

1. Keep the developing world in through better goal specification

This chapter has identified some of the problems resulting from the focus on development in the new round. While it would be politically unfeasible to backtrack from this broad aim at this late stage, negotiators could try to be more precise on what such goals might entail in this round or any future ones. This would provide a safeguard against the WTO being held up against unfair expectations, or being blamed for tasks it was never meant to or empowered to carry out. Additionally, governments must recognise that the mandate of the WTO is centrally about trade, while there are several other organisations within the umbrella of the UN that are better able to deal directly with development concerns. The WTO cannot – and should not – be held responsible for all the problems that are associated with development.

2. Keep the developed world in by widening the zone of agreement

Ideally, sufficient thought should have gone in from the very beginning of the DDA to keep the developed world committed to multilateral trade liberalisation through means other than the controversial Singapore issues. But even reframing the zone of agreement would help, so that business groups in developed countries saw some real gains from the round. This would involve changing the language of the round, and also of future trade negotiations, from charity to reciprocity.

3. Improve negotiation processes

While the improved inclusiveness of WTO decision making is a welcome change, it does detract from the efficiency of the club-like model of decision making among like-minded OECD countries of the years of the GATT and the early WTO. Some reform of institutional process is clearly necessary. This reform need not take the shape of weighted voting. Even radical institutional reform could be limited to introducing new decision-making mechanisms such as a critical-mass approach and a bigger role for the secretariat.

But, more immediately, the members of the WTO themselves can improve institutional process. For instance, they can find better ways of trust building in negotiation that would help them move beyond the recurrent stalemate that we see in the WTO today. Such measures would involve better signalling techniques, which could allow opponents to distinguish between cheap talk and real bottom lines. It could also involve some scope for innovating chairing and mediation, as can still be carried out under the mandate of the WTO.

4. Enhance the legitimacy of the organisation

While the attention to issues of fairness in recent years is a positive development, it has not been accompanied by a comparable commitment to efficiency and effectiveness. This is a very serious omission, which has contributed to the disengagement of both developed and developing countries from the organisation: fairness is a noble consideration, but who wants to rely on an organisation that is fair but entirely ineffective in reaching decisions? It is only by finding the balance between these two, sometimes divergent, goals of fairness and efficiency that negotiators will be able to sell the legitimacy of the organisation to politicians and their constituencies in the developed and developing worlds.

5. Increase the coherence of international economic governance

Mission creep in the WTO could be avoided if better mechanisms were established that allowed trade governance to be linked with other aspects of economic governance, particularly the development-related organisations on the one hand and those dealing with financial stability on the other. In light of this recommendation, while world leaders today are to be commended for their efforts to reconstruct international economic institutions, their emphasis on a "new Bretton Woods" is perhaps less fortunate for two reasons.

First, among all the post-war economic institutions, the Bretton Woods twins have perhaps enjoyed the least legitimacy. They have been particularly resented by developing countries for their systems of weighted voting, their use of controversial conditionalities, and their unwillingness to reform their decision-making structures to accommodate rising powers. Calling for a "new Bretton Woods" brings this baggage of acrimony and resentment to the negotiating table.

Second, trade was the missing link in Bretton Woods 1944, with the International Monetary Fund and the World Bank focusing on the regulation of the international monetary and financial system. Even though politicians and negotiators had learned of the dangers of delinking trade and finance via the protectionist "beggar thy neighbour" policies that had exacerbated the Great Depression in the inter-war years, trade negotiations even in the post-war years have been placed in a separate box. The failure to establish a clear institutional linkage between trade and finance means that the risk of protectionism is very high in the current financial climate. This is why any attempts to reform the international financial system must be accompanied by an equally serious and closely linked effort to reform the multilateral trading system.

Rather than negotiate a "new Bretton Woods", our leaders must begin with a clean slate. There is no consensus on what the solutions will be, but one thing is clear. Trade ministers and their bureaucrats must have an equal say in any fix that finance ministers and central bankers attempt to provide to the global problems we face today. After all, as Pascal Lamy has pointed out, trade is not a cause of the financial crisis today but it may provide a solution.

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Chapter 6

The contribution of free and fair trade to constitutional liberty and justice

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The contribution of free and fair trade to constitutional liberty and justice

There is today worldwide agreement among economists that international trade liberalisation increases the economic welfare of all trading nations and contributes also to poverty reduction. China and India are powerful examples of the gains from freer trade in the past two decades. Trade liberalisation reduces the prices of consumer goods, enhances productivity, creates new job opportunities and enables governments to redistribute part of the "gains from trade" for helping the poor and granting adjustment assistance to workers shifting from import-competing to export sectors of the economy. Yet, even though voluntarily agreed trade transactions tend to be mutually beneficial, the social benefits of trade and competition depend on non-discriminatory, legal regulation of "market failures" (such as competition rules limiting abuses of market power) and constitutional safeguards of "social justice".

This chapter briefly explains why private commercial law and national and international trade law are among the oldest fields of law that are – both inside states and among states – increasingly important for promoting legal freedom and mutually beneficial, peaceful co-operation among citizens across frontiers. United Nations human rights bodies now support international trade liberalisation as a citizen-driven instrument for enhancing welfare, reducing poverty and promoting non-discriminatory economic regulation without "exclusion of the other". Protectionist conceptions of "fair trade" and "social justice" unnecessarily restrict freedom of citizens and their economic welfare.

From civil society to economic and legal communities

No individual can produce all the goods and services he or she uses. Most people survive by trading the fruits of their labour in exchange for the goods and services they need. The living standards of all individuals depend on division of labour, trade and competition resulting from the exercise of economic liberties; markets reflect citizen-driven dialogues about values (for example, prices) and offer decentralised information, co-ordination and sanctioning mechanisms revealing the preferences, supply and demand of citizens. As all citizens tend to be producers, traders and consumers of scarce goods or services, civil societies are inevitably economic and legal societies.

Liberty and the efficient functioning of markets depend not on the silence of the law (as suggested by J Bentham), but on legal rules protecting equal freedoms (such as freedom of profession), reducing transaction costs (for example, by means of contract law), setting incentives for investments and savings (by such means as economic liberties and property rights), preventing market failures (by means of competition rules, for instance) and providing for collective supply of public goods (such as legal security, monetary stability, protection of human rights, and prohibition of slave and opium trading).

From time immemorial, trade transactions have given rise to commercial usages and contractual practices for the allocation of commercial risks in contracts of sale, arrangements for the carriage, insurance, delivery and payment of goods, and commercial arbitration and recognition of arbitral awards as alternatives to submitting disputes to the municipal law and domestic courts of one party to the possible disadvantage of the foreign party to the trade transaction.

Particular rules for regional commerce existed in the Babylonian Code of Hammurabi, in the laws of ancient Greek cities and in Roman law, as well as in the medieval "law merchant", which was not only a privately agreed law of merchants but evolved also into customary rules approved by governmental authorities (for example, regulating international fairs, governmentally controlled "staple" places, banking, foreign exchange, commercial arbitration and corporations with separate legal personality). Since the 17th century, this medieval *lex mercatoria* has become incorporated into national legislation (such as commercial and maritime codes) as well as into English common law.

From mercantilism to constitutional liberty in domestic trade laws

Adam Smith's *The Wealth of Nations* in 1776 criticised the arbitrariness and economic waste of governmental mercantilism, colonialism, monopolies and discriminatory trade restrictions limiting consumer welfare. Smith's proposals for a "natural system of perfect liberty and justice" explained why legal protection of individual liberty, security, private property and open markets, supplemented by legal limitations of restraints of competition (such as cartel agreements), could greatly enhance individual and social welfare.

The US Constitution in 1787 and the French Constitution in 1791 offered comprehensive constitutional approaches for protecting "life, liberty, property and due process of law" in the polity as well as in the economy. While the US Bill of Rights took the common law guarantees of freedom of contract, freedom of profession and private property for granted, national constitutions in European civil law countries often explicitly protected economic liberties (such as freedom of profession and establishment).

The German and Swiss confederations during the 19th century repeated the historical experience of the US confederation that creation of a common market required federal guarantees of market freedoms, property rights and their legislative and judicial protection. Following the Second World War, decolonisation and the end of communism, most of the 192 UN member states have adopted national constitutions protecting economic freedoms inside national markets.

Since Adam Smith, there is growing consensus on why domestic institutions – such as contract law, freedom of profession, property rights, stable money, legal protection of open markets, judicial protection of legal security and peaceful settlement of disputes – may influence economic welfare no less than do domestic natural and human resources.

Legal positivism and economic utilitarianism argued for government discretion for regulating the economy and maximising "national welfare". Constitutionalism, by contrast, emphasises the ubiquity of abuses of private and public power which must be limited – in the economy no less than in the polity – by legal guarantees of a higher rank protecting equal freedoms, open markets and non-discriminatory conditions of competition, as they have become adopted in most constitutional democracies and in increasing numbers of regional economic integration agreements. Just as Adam Smith had perceived liberty and justice as ends as well as means for maximising social welfare, modern theories of justice emphasise the need for "principles of justice" legitimising the constitutional and legislative regulation of the economy.[1]

Yet, in contrast to the "enlightenment conceptions" (of Adam Smith and Immanuel Kant, for instance) of justice in terms of equal liberties, modern theories of justice emphasise also the need for "difference principles" compensating the unequal distribution of resources by preferential treatment of the least advantaged.[2] According to Rawls, individuals have not only fundamental self-interests in rationally pursuing their conception of a good life and in successfully realising their particular life plans; they also have the ability and desire to co-operate with others in chosen social orders based on shared conceptions of justice that constrain the "two moral powers" of human beings to develop an individual sense of justice and a conception of the good.[3]

In modern constitutional democracies, market economies tend to be "founded on principles of liberty, human rights, democracy and rule of law" (according to article six of the EU Treaty) rather than only on paternalist government discretion and utilitarian assumptions of individuals as "rational maximisers" of their self-interests.

1 See: Petersmann, EU "Theories of Justice, Human Rights and the Constitution of International Markets" in *Loyola Law Review* 2004, pp407-460
2 On equal basic liberties and the "difference principle" as two principles of justice, see: Rawls, J *A Theory of Justice* (Belknap, 1971), p60
3 Rawls, op cit, p74, p229

Constitutional functions of international trade agreements for limiting "governance failures"

International trade agreements for reciprocal market access have been concluded since time immemorial (for instance, between the ancient Greek city republics in the Mediterranean). The economic case for free trade argues for *unilateral* trade liberalisation. Hence, most economists admit[4] that the main reasons for concluding trade agreements are political rather than economic (for example, peaceful co-operation in Europe or preferential co-operation with former colonies). Lawyers emphasise the "constitutional functions" of trade agreements for limiting "governance failures" at home (such as by restraining protectionist pressures from import-competing industries, or enlisting support from exporters for reciprocal trade liberalisation) as well as abroad (for instance, limiting adverse "external effects" of trade policies of other countries, promoting international legal security and peaceful settlement of disputes).

Many regional trade agreements are explicitly concluded in order to abolish discrimination and promote political unity (for instance, inside the German Customs Union in 1834-1866); the European Community treaties, for example, have evolved into the most effective international peace treaties ensuring peaceful co-operation among the 27 EC countries and fundamental freedoms for their 480 million EU citizens. Since the universal recognition of inalienable human rights in national laws as well as in regional and UN law, European courts have increasingly interpreted intergovernmental trade agreements from a citizen perspective (as constituting individual "market freedoms" inside the EC, for instance) rather than only from the power-oriented perspectives of states and governments.

Kant's legal theory of rights explains why respect for human dignity (in the sense of rational and reasonable autonomy and moral responsibility, for instance) requires constitutional protection of equal basic freedoms (as "first principle of justice") in all human interactions at national, transnational and international levels.[5] Human rights, in conformity with Kantian legal theory, require us to interpret state sovereignty, popular sovereignty and "individual sovereignty" in mutually consistent ways: just as states and national laws are mere instruments for protection of human rights and for the collective supply of public goods demanded by citizens, so are international trade and international law mere instruments for realising individual and democratic self-development through the collective supply of international public goods and protection of human rights across national frontiers.

4 See: World Trade Organization *World Trade Report* 2007, p50
5 See: Kant, I "Perpetual Peace" in Reiss, H (ed) *Kant: Political Writings* (Cambridge University Press, 1991), p93, p98

Even though the Kantian conception of *maximum* equal liberties is recognised in the constitutional laws of only a few European countries (such as Germany), UN human rights bodies have recently begun to acknowledge the contribution of liberal trade to consumer welfare, poverty reduction and human rights (for instance, access to food, essential medicines and education, and freedom of profession).[6]

Multilevel governance for the protection of international freedom of trade has promoted "multilevel constitutionalism"

The conclusion of more than 250 regional trade agreements and the transformation of the General Agreement on Tariffs & Trade, which was set up in 1947, into the World Trade Organization in 1995 with a worldwide legal system for rule making and compulsory jurisdiction for peaceful settlement of international trade disputes at national and international levels demonstrate that trade has led to the most comprehensive international treaty regimes.

Civil society and parliaments no longer perceive international trade law only as "international law among states" based on state sovereignty, but also as "international law among peoples". In fact, this development looks towards a cosmopolitan "international law among citizens" justifying the – since 1999 regular – parliamentary co-operation at WTO ministerial conferences as well as the increasing number of WTO guarantees of individual "trading rights" (such as in the WTO protocols for the accession of China and Vietnam), property rights and individual rights of access to judicial remedies.

The global scope of WTO guarantees of equal freedoms, open markets, non-discriminatory conditions of competition, rule of law and welfare-enhancing policies goes far beyond the corresponding rules of any other organisation. For example, UN human rights law protects only minimum standards that remain below the human rights guarantees in many constitutional democracies as well as in European law; the scope of the WTO guarantees of market access and judicial protection of rule of law, by contrast, goes far beyond those in regional trade agreements and autonomous national trade laws. By requiring the 153 WTO members to base restrictions of freedom of trade on transparent tariffs and non-discriminatory regulations of "market failures" and "public goods", and by providing for preferential treatment of less-developed countries, WTO rules reflect basic principles of justice.

The common market law of the EU and of the European Economic Area, and the judicial protection (by the EC and European Free Trade Association courts, for instance) of the

6 See: Petersmann, EU "The 'Human Rights Approach' Advocated by the UN High Commissioner for Human Rights and by the ILO: Is it Relevant for WTO Law and Policy?" in *Journal of International Economic Law* 2004, pp605-628

"market freedoms" of EU citizens as fundamental rights, present the most ambitious realisation of Adam Smith's and Immanuel Kant's "enlightenment ideals" of constitutional protection of equal liberties founded on justice. EU and EEA law combine Adam Smith's proposal of enhancing individual and national welfare by extending economic liberty across national frontiers with Kant's proposal of multilevel constitutional protection of equal liberty rights across frontiers. This "constitutional approach" to trade regulation also reflects the human rights requirement to recognise citizens as legal subjects and protect their mutually beneficial "propensity to barter and exchange"[7] beyond constitutional democracies.

Empowering self-interested citizens as guardians and decentralised enforcers of international trade rules ratified by parliaments has proven to be the most effective and, arguably, most democratic legal method for the collective supply of international public goods. The judicial protection of the intergovernmental EC and EEA "market freedoms" as constitutional rights of European citizens, subject to respect for human rights and competition rules, can assert both utilitarian legitimacy (in terms of promoting consumer welfare, for instance) as well as "constitutional legitimacy" (in terms of respect for market-driven offer and demand by citizens as "democratic principles" of governments).

The more governments co-operate internationally for the collective supply of "international public goods" (such as an open trading system benefiting all trading countries), the more multilevel governance in international organisations is leading to functionally limited "treaty constitutions" complementing national constitutions for the collective supply of national public goods. Since the "constitution" *(sic)* that established the International Labor Organization of 1919, many other constituent agreements of international organisations – such as the World Health Organization and the Food & Agriculture Organization – have also been called "constitutions" because they:

- constitute a new legal order with legal primacy over that of the member states;
- create new legal subjects and hierarchically structured institutions with limited governance powers;
- provide for institutional checks and balances (such as among rule-making, administrative and dispute-settlement bodies in the WTO);
- legally limit the rights of member states (regarding, for instance, withdrawal, amendment procedures and dispute settlement procedures);
- provide for the collective supply of "public goods" that – as in the case of the above-mentioned treaty constitutions (of the International Labor Organization, the

7 Smith, A *An Inquiry into the Nature & Causes of the Wealth of Nations* vol 1 (Liberty Classics edition, 1776/1976), p25

World Health Organization and the Food & Agriculture Organization) – are partly defined in terms of human rights (such as core labour rights, and the human rights of access to health and food); and often
- operate as "living constitutions" whose functions – albeit limited in scope and membership – increasingly evolve (through "WTO rounds" of multilateral negotiations, for instance) in response to changing needs for international co-operation.

Even though such "treaty constitutions" differ fundamentally from national constitutions by their limited policy functions and less effective constitutional restraints, they are becoming no less necessary for the collective supply of public goods (such as poverty reduction through a mutually beneficial trading system) than national organisations. Upholding human rights requires designing national and international governance as an integrated, multilevel constitutional framework for the protection of citizen rights, democratic self-government and co-operation among free citizens across frontiers.[8]

"Fair trade" depends on non-discriminatory economic regulation and respect for human rights

As supply and demand in economic markets are driven by human self-interests, many human rights defenders and social justice philosophers are critical of the selfish pursuit of individual interests through trade and economic rivalry. Yet, in a world of scarcity and arbitrary distribution of resources (including human capacities), legal and judicial protection of equal liberties, property rights and human rights are "principles of justice" essential for individual self-development and responsibility, voluntary savings, investments and market prices that reflect the demand and supply of scarce goods and services.

Democratic constitutionalism – in the economy no less than in the polity – depends on limiting the inherent tendencies of freedom to destroy itself (such as through selfish restraints of competition) by constitutional restraints on abuses of private and public power. Just as democratic self-governance in political markets depends on constitutional protection of civil and political human rights, so does consumer-driven self-governance in economic markets depend on empowering citizens through economic and social rights and competition laws that limit the abuse of market power.

International trade law has been a driving force in the emergence of *international constitutionalism* as a functionally limited, but necessary complement to *national constitutionalism*. Only together as interrelated networks based on "constitutional pluralism" can they protect human rights and democratic self-government effectively in

8 See: Joerges, C and Petersmann, EU (eds) *Constitutionalism, Multilevel Trade Governance & Social Regulation* (Hart, 2006)

a globally interdependent world. Even though trade liberalisation will produce winners and losers, it tends to increase national wealth inside each of the trading partners in ways that also benefit the poor (such as by increasing their real income and choice through more, better and lower-priced goods and services). Yet economic and social human rights and the "cosmopolitan justice" of international law remain contested,[9] especially in the many less-developed countries whose governments fail to protect human rights, democratic governance and "social market economies".

Similar to article 1 of the UN Charter, the Vienna Convention on the Law of Treaties codifies the customary law requirement that "disputes concerning treaties, like other international disputes, should be settled by peaceful means and in conformity with the principles of justice and international law", including human rights.[10] The WTO Agreement recognises "basic principles ... underlying this multilateral trading system"[11] and calls for interpreting WTO law "in accordance with customary rules of interpretation of public international law".[12] Hence, WTO rules should be construed "in conformity with principles of justice" and human rights.

The basic principles underlying WTO law – such as freedom, non-discrimination, rule of law, independent third-party adjudication and preferential treatment of less-developed countries – can be justified by all liberal theories of justice, such as:

- utilitarian theories defining justice in terms of maximum satisfaction of individual preferences and consumer welfare;
- libertarian theories focusing on protection of individual liberty and property rights;
- egalitarian concepts defining justice more broadly in terms of equal human rights and democratic consent; and
- international theories of justice based on sovereign equality and effective empowerment of states to increase their national welfare through liberal trade.[13]

Thus, the diversity of libertarian, egalitarian or utilitarian value preferences should not distract from the fact that the WTO guarantees of freedom, non-discrimination and rule of law – by enhancing individual liberty, non-discriminatory treatment, economic welfare and poverty reduction across frontiers – reflect, albeit imperfectly, basic principles of justice. The numerous WTO "safeguard clauses" and "exceptions" reserve the right of every

9 For non-cosmopolitan views of international distributive justice, see: Rawls, J *The Law of Peoples* (Belknap, 1999), p113
10 Preamble to the Vienna Convention on the Law of Treaties
11 Preamble to the WTO Agreement
12 Article 3.2 of the Dispute Settlement Understanding (DSU) of the WTO Agreement
13 Petersmann, op cit (2004)

WTO member to protect "public interests" that are deemed more important than liberal trade, including protection of "fair trade" (for instance, by means of "anti-dumping duties").

In terms of the Aristotelian distinction between "general principles of justice" (such as liberty, equality, fair procedures and promotion of general consumer welfare) and particular principles of justice requiring adjustments depending on particular circumstances, WTO rule making and WTO dispute settlement procedures can contribute also to "corrective justice" and "reciprocal justice", just as the special, differential and non-reciprocal treatment of less-developed WTO members in numerous WTO provisions may contribute to "distributive justice".

Conclusion

Economists and utilitarian politicians tend to discuss the WTO only in terms of economic costs and benefits. Yet, just as the EC Treaty has evolved from a customs union into the most effective peace treaty in European history, so has the WTO Agreement evolved into the most effective, worldwide legal and compulsory dispute settlement system protecting, albeit imperfectly, mutually beneficial trade and poverty reduction for the benefit of citizens all over the world.

The WTO's *World Trade Report 2007* – in its retrospective analysis of 60 years of GATT and of the question "What have we learned?" – emphasises the "constitutional functions" of WTO law for protecting freedom, non-discrimination, rule of law and transparent governance in international trade,[14] notwithstanding the numerous failures of the WTO legal and political system. The fact that, since 1999, inter-parliamentary meetings and participation of non-governmental organisations have become regular features at all WTO ministerial conferences reflects the increasing political awareness of governments, members of parliaments and civil society that a liberal (meaning liberty-based) world trading system is of essential importance for citizens whose welfare increasingly depends on worldwide division of labour.

As the unnecessary poverty of 1 billion people living on $1 per day or less, the obvious failures in the regulation of international financial markets, and the adjustment problems created by rising food and energy prices and climate change cannot be remedied without an open trading system, citizens have good reasons to second-guess their "rational ignorance" vis-à-vis the complexities of the collective supply of "global public goods".

14 World Trade Organization, op cit, pp79-98

Open markets and international competition are of crucial importance for promoting the social, political and legal adjustments necessary for empowering citizens to benefit from the opportunities of "globalisation"; yet the inevitable adjustment costs will remain socially and politically acceptable only if "market failures" (such as those in financial markets, or environmental protection) are regulated more effectively so that the social benefits from the international division of labour and from the collective supply of other "international public goods" are distributed more fairly. For example, without stronger democratic support for the collective protection of a rules-based, open world trading system, the WTO's "development round" will hardly be concluded successfully, with considerable costs for economic productivity, consumer welfare and poor people, especially in less-developed countries.

The author was a legal adviser for GATT (1981-1994) and a legal consultant in the WTO (1994-2007), and has been a chairman, member or secretary of numerous GATT and WTO dispute-settlement panels.

Chapter 7

Fairtrade versus free trade

Harriet Lamb, Executive Director of the Fairtrade Foundation

Fairtrade versus free trade

"We are trying to create a little bubble in the global economy where we do trade differently, where we show it can be done successfully by putting people first," said pioneer Robin Murray, as over a decade ago he battled to get Cafédirect on to shop shelves. At that time, supermarket buyers laughed in our faces. One said he was not going to stock the first Fairtrade chocolate "just because it's backed by a bunch of Christians". But as the grass-roots campaign gathered pace, it was not long before he was back on the phone: "You'd better get over here," he said. "We're being bombarded by telephone calls. From vicars!" Since then, that little bubble has expanded dramatically, but the challenge before the movement remains pressing.

Fairtrade is one of Britain's most extraordinary social change success stories, thanks to the thousands of campaigners who have tirelessly talked about Fairtrade, pranced around high streets in wonderful costumes, and given out mountains of chocolate to sweeten the drip, drip, drip of information.

A flurry of recent research has shown that the Fairtrade mark is now the most recognised ethical label, by a long way. A recent survey by TNS Omnimas found that seven out of 10 members of the public recognise the Fairtrade mark. Sales increased in 2007 by 72% to almost £500 million, as over 4,000 Fairtrade products have been licensed to carry the Fairtrade mark in the UK. As a result, some 7.5 million farmers, workers and their families in developing countries participate in Fairtrade.

Today one in four bananas sold in the UK, including all bananas from the Windward Islands and all those in Waitrose and Sainsbury's, carry the cheery blue-and-green Fairtrade label. It gives a glimpse of just how far Fairtrade can go – that it can become part of a nation's shopping habits, and so could perhaps achieve significant shifts in markets and affect entire economies.

The challenge now is to take this prototype and extend the reach and impact of Fairtrade, ultimately tipping the balance of British trade with poor producers decisively in their favour.

A simple idea

The Fairtrade Foundation was established in 1992 by CAFOD, Christian Aid, Oxfam, Traidcraft and the World Development Movement as a response to the failures of the newly liberalised world trade market. These founding organisations were later joined by Britain's largest women's organisation, the Women's Institute. At the time, the ideological drive for liberalisation at all costs was rolling out across the world. The International Coffee Agreement, which had managed supply and demand, was torn up as "markets" were seen as the answer. As prices crashed, farmers stared destitution in the face.

In response, the idea of Fairtrade was beautiful in its simplicity: that disadvantaged farmers and workers should get a fair price that covers their costs of production with a premium to invest in the future. The means to put the principle into practice is the Fairtrade mark, an independent label that enables the consumer positively to choose products that are giving disadvantaged producers a fair deal.

Fairtrade is unique because it takes all the rules of the free market and stands them on their head – and yet is succeeding in the mainstream market. For the Fairtrade system puts social and environmental concerns first, not last; ensures prices are sustainable, not at the lowest level possible; gives information, market access and so an element of power to consumers and producers rather than taking information and power away; and enables smallholders to prosper while the mainstream market tends to ever greater consolidation. And it is succeeding because organised producers and ethically minded consumers have come together to create the opportunities for companies to meet Fairtrade rules and succeed commercially. When, for example, in 2007 Sainsbury's switched all its bananas to Fairtrade, sales rose by an astonishing 10%.

Frans van der Hoff, a Dutch priest living with Mexican coffee farmers, was among the founding fathers of Fairtrade who aimed to rewrite the conventional rules of trade by using the normal channels of business but enabling the producers and consumers to set the rules. He explains that Fairtrade:

... does not disrupt the normal mechanisms of the dominant market. It doesn't create artificial commercial conditions but rather, new ones based on justice. To pay the producer the real prices for producing a product is not only economically rational but is grounded in the most elementary of ethical principles.

Benefits all round

Some free-marketers are uncomfortable with Fairtrade's intervention in the market. But there is much that they should be cheering. Firstly, Fairtrade is a voluntary intervention that extends consumer choice. It has been driven by consumers who have created the space within which companies can make big, bold decisions about changing their supply chain practices. Argument can rage back and forth about whether business has a responsibility to contribute to the alleviation of poverty. But every business would agree that their job is to meet consumer demand.

And most companies overwhelmingly welcome the opportunity this gives them to do right by producers, while responding to the public and adding value to their products. The relentless downward pressure on commodity prices is not in companies' interests, as all products are devalued. Between 2005 and 2007, the price of bananas in British supermarkets was cut by some 30% in a price war, going from 85p in 2005 to 59p in 2007. The strategy was about taking market share from competitors rather than increasing overall sales.

By contrast, Fairtrade enables companies to put value back into products, to talk about their provenance, to differentiate the products, to engage consumer interest in attributes beyond price – and at the same time to secure long-term quality relationships with their suppliers.

Moreover, Fairtrade is encouraging competition. For it is in fact enabling smallholder associations to stay in business when too many commodity markets – such as tea or bananas or coffee – are virtual global monopolies controlled by a handful of vast multinational companies buying from a shrinking number of producers.

Indeed, Fairtrade is facilitating the flourishing of a whole new generation of organised farmers' associations running as successful businesses. This is enabling the farmers to capture more of the value of their products, reduces middlemen and builds the farmers' capacity. Arturo Gomez, a banana farmer from the Costa Rican organisation Cooptrabasur noted:

Before I was someone that took a box and loaded it onto a train. That was my only responsibility. I was just a farmer, who was an intermediary. In this new system I have become an international businessman.

That is good news for the farmers; but it is also good for their importing partners for whom the farmers become the best of business partners.

The positive developmental impact of Fairtrade has been confirmed by independent academic studies as well as anecdotal evidence. There are thousands of impact stories from thousands of Fairtrade producers, each of them with a different focus depending on the needs and requirements of the producer and their organisation group. What they have in common is that Fairtrade has supported them to develop their democracy, transparency, participation and empowerment.

Independent research shows that the direct and indirect impacts of Fairtrade are mediated in four ways:

- First, through the trading standards (via the minimum price, Fairtrade premium, pre-financing and long-term trading relationships). FLO, the multinational association that develops and reviews Fairtrade standards, estimates that in 2005 the benefits to producers amounted to around €80 million in terms of the Fairtrade minimum price and premium.

- Second, through access to markets to sell their products and the organisational support that is often provided by companies engaging in Fairtrade.

- Third, through the organisation that is at the heart of the producer standards (via organisational change made to meet minimum standards for certification and progress standards for continuous improvement). The strengthening of farmers' organisations is a key means for farmers to change their position in the supply chain and to organise trades unions. For example, in Kenya, the Kenyan Plantation & Agricultural Workers Union was able to work with flower farms to organise workers and negotiate a collective bargaining agreement directly as a result of the decision to engage with Fairtrade.

- Finally, through the networking opportunities that involvement in Fairtrade can bring, such as the Africa Fairtrade Network, the Network of Asian Producers and the Coordinadora of Latin American and Caribbean producers.

Effects on producers
The impacts of Fairtrade for smallholders and workers are experienced at three levels, examples of which are described below:

Producer and family
In Costa Rica, the collapse in coffee prices in the late 1990s forced many smallholders to sell up and move to the cities in search of work. Many of these farmers can be seen in the cities sleeping rough or living in ghettos, their children sucked into drugs, gangs, crime and prostitution. This has not been the case for members of the Coocafé co-operative. According to Gerado Camacho, a Coocafé member:

The Fairtrade price allows us to survive as coffee farmers. It covers our costs of production, lets us send our kids to school, buy clothes and keep a roof over our heads.

Producer organisation
When the reputation of Ugandan coffee suffered following liberalisation of the coffee industry, the Gumutindo Co-operative, supported by Fairtrade and working with

Cafédirect, invested in agricultural training, organic conversion and improved processing methods to raise the quality of its coffee. Buyers are now knocking on the co-operative's door and farmers are queuing up to join the organisation.

To take another example, cotton producers from the Dougoroukoroni co-operative in Mali chose to spend their first Fairtrade premium payment on building a small, two-room schoolhouse. Members gained a new sense of empowerment, thanks to Fairtrade. They now felt confident enough to negotiate with the local government to ensure that they lived up to their responsibilities. The result was a brand-new school for approximately 160 pupils funded jointly by the local government and the co-operative.

An early study of coffee producers in Uganda and Tanzania[1] found that Fairtrade had brought a range of benefits, including opening the gates for the co-operatives to export markets and improved access to coffee market information. The same study also found that it was only because of the higher Fairtrade price and Fairtrade premium that some co-operatives were able to survive the collapse in coffee market prices in 2001.

A more recent study of the Heiveld Rooibos Tea Co-operative in South Africa[2] found that Fairtrade was playing a critical role in its success by providing access to a high-value market and supportive relationships with a network of buyers as well as direct financial assistance for infrastructure and business development. As a result, Heiveld was a stronger and more sustainable business and organisation that in turn could provide a range of benefits to the local community. These included increased incomes and employment opportunities and the development of a greater sense of community and individual self-worth.

Community

The Fairtrade premium is often invested in schools, hospitals and clinics, and in environmental projects decided by the farmers democratically. These projects contribute towards efforts to meet the internationally agreed Millennium Development Goals in health, education and environmental sustainability. For example, in the Windward Islands, the Fairtrade premium has been used to build three nursery schools, which means older children do not have to miss school to look after their younger siblings while their mothers are harvesting bananas.

1 Tallontire, A, Greenhalgh, P, Bee, F and Kyamanywa, J *Diagnostic Study of FLO Registered Coffee Producers in Tanzania & Uganda* (Department for International Development, 2001)
2 Smith, S *Fairtrade Foundation Reflect & Review* (Fairtrade Foundation, 2006)

A study of the Ghanaian cocoa-producing group Kuapa Kokoo[3] found that the community projects funded through the Fairtrade premium were having a development impact upon the wider community as well as Kuapa members. For example, over 100,000 people in the community benefited from free medical attention and prescriptions, and a school building project funded by the premium had "emphatically improved pupil attendance and health and the quality of education".

Challenging questions for Fairtrade

But as companies, think tanks and governments take Fairtrade more seriously, they also raise more challenging questions.[4]

Critics, for example, assert that farmers outside the scheme are left worse off. But this is not only theoretically muddled – why would prices for some farmers fall if others receive a higher price? It is factually wrong. Take the word of John Kanjagaile, export manager of the Kagera Co-operative Union, with its 60,000 farmers in 125 local village co-operatives scattered across hilly countryside on the western shores of Lake Victoria: "We sell a small percentage of our coffee as Fairtrade but the benefits are much, much wider." He says that the certainty of the prices and orders that the co-operative gets for its Fairtrade coffee enables it to push up all prices in the coffee auction, so benefiting neighbouring farmers that are not yet able to sell anything under Fairtrade.

This experience was confirmed by independent research in Bolivia, which concluded that Fairtrade was becoming a price setter. The study showed that when Fairtrade-certified coffee producers in Bolivia received higher Fairtrade prices for their products, this also developed the confidence of other, conventional coffee producers to demand higher prices for their coffee. It is a virtuous circle that is good news for all farmers and is surely no more than the market operating at its best.

Other critics charge that Fairtrade encourages overproduction when farmers would be better off diversifying or improving the quality of their produce. We entirely agree that farmers indeed need to add value to their products, to improve quality and to diversify. But the question is: what encourages such diversification? Most poor farmers have few choices – that is part of the definition of poverty. They grow the one crop they know about and that suits their soil; they cannot, to adapt the words of UK politician Boris Johnson on redundant steelworkers, start selling cappuccinos on the internet overnight.

3 Ronchi, L *Monitoring Impact of Fairtrade Initiatives: A Case Study of Kuapa Kokoo & the Day Chocolate Company* (Twin, 2002)
4 Imhof, S and Lee, A *Assessing the Potential of Fair Trade for Poverty Reduction & Conflict Prevention: A Case Study of Bolivian Coffee Producer* (swisspeace/Europainstitut at the University of Basel, June 2007)

Therefore – contrary to classical economic theory – against a backdrop of falling prices, farmers too often embark on a desperate and (usually hopeless) quest to maintain their meagre living standards by actually bringing more crops to markets. Or they are forced to leave their land and further swell the population of urban slum dwellers or illegal immigrants.

So, Fairtrade is one solution enabling farmers to remain on their land and on the right side of the poverty line, with enough for today and a little extra to invest in a better life for tomorrow. Indeed, Fairtrade also provides some solutions to preventing overproduction. For the extra finance and certainty, the market information, organisation and contacts that come through Fairtrade give producers the resources and opportunities to improve the quality of their crops, to go organic or to diversify into other ways of supplementing their livelihoods. Coffee farmers in Costa Rica have started processing their coffee while also selling macadamia nuts; cotton farmers in Mali have planted vegetables to eat and sell locally; in St Lucia banana farmers have bought computers to equip young people to compete for jobs in tourism.

But what about when the market for food is buoyant, as it is now, with prices of many commodities such as coffee high? Certainly, in the Fairtrade system we need to review constantly our standards to ensure they are serving their function. We have, for example, just reviewed and introduced a new set of cotton prices to respond to a changing market. But while the precise manifestation may vary over time, the case for standards to help ensure that farmers can tackle poverty and promote sustainable development remains as relevant as ever.

Indeed, now more than ever, producers need Fairtrade, to earn a living to feed their families and meet the rising costs of food and fuel. If people in the rich world are feeling the credit crunch, then the impact is proportionately harsher for disadvantaged producers. The poor typically spend 50-80% of their income on food, so farmers are hit hard. Tea growers in Uganda have reported that while tea prices have risen only slightly, the cost of fuel for their lorries to collect tea has doubled and fertiliser prices have also increased. In Kenya, the price of a bag of maize rose 100% between January and July, leaving workers on flower farms, who typically spend half their income on food, struggling to manage.

Managing markets

The Fairtrade movement grapples daily with a multitude of complex questions, and constantly reviews its model as we seek to open more doors to more markets for more producers – especially from the least developed countries. For the reality is that we have to manage markets to achieve desired social and environmental outcomes – including, for example, to ensure that we do not have lower prices at the expense of real value.

In recent decades, the notion of intervening in markets for social outcomes was economic heresy. But in the tumultuous events of the last months of 2008, the limits of unbridled liberalisation have become all too apparent as banks and stock markets have collapsed, and a storm of calls for intervention and for controlling the private sector have echoed round the world.

As UK prime minister Gordon Brown said to the Labour Party conference:

Just as we know that governments cannot and should not do everything, so too we know that markets cannot deliver it all on their own … those who argue the dogma of unbridled free market forces have been proved wrong again.

It is not a criticism of markets to say that they will not deliver fairness, justice or sustainability – a market is an economic model, but trade is also a social activity that happens between people and not just commodities. Sometimes, freer trade does indeed help create wealth and tackle poverty. To remove US cotton subsidies, which have led to the dumping of artificially cheap cotton and depressing of cotton prices in West Africa, would indeed be a move towards freer and fairer trade. But that is not automatically the case. Similarly, while trade is necessary and can help stimulate much-needed economic growth, it is not sufficient – it will not automatically lead to development or reduce poverty. This is why trade must be managed in ways to deliver the best results.

The much-misquoted Adam Smith himself wrote about the fact that free trade is not a natural outcome of business but one that needs to be regulated by governments to maintain free and fair exchange. Indeed, over time, core aspects of business are regulated at a national level in a multitude of ways – to ensure that workers get a minimum wage, that health and safety rules are followed, that children do not work.

As Winston Churchill argued in the last century (during debates on minimum wages in certain sectors), without them, "the good employer will be undercut by the bad, and the bad by the worst". Likewise, we believe that the global trading system needs regulating to ensure that when markets fail, there is a minimum level of fairness. In the absence of global systems to ensure trade is managed fairly, Fairtrade is a voluntary regulation that seeks to put markets at the service of people, rather than the other way round – which is simply the way things should be.

Indeed, the Doha round of talks at the World Trade Organization was touted in 2001 as the "development" round, in recognition of the need to refocus the framework of world trade regulation on promoting development. But those initial objectives were soon swamped by the usual horse trading as world powers sought to protect their trading dominance and failed to put the interests of developing countries first. Shamefully, world leaders let the talks limp on for years, finally collapsing totally in July 2008.

The collapse was greeted with undisguised fury across the developing world. Cotton growers in Burkina Faso will suffer from the failure of world powers to conclude a global trade pact, said its trade minister, Mamadou Sanou, on 30 July. "We can hardly control our anger," he said. As the co-ordinator of the West African cotton producers, he had been pressing the US to lower domestic subsidies that depress world cotton prices at poorer countries' expense. Now, he said, Burkino Faso's cotton industry, which accounts for over half its export earning, faces "extinction". Sanou said: "We are most disappointed that the rich countries, the champions of liberalisation who urge us to liberalise our trade and our economies, are afraid to trade with us on an equal footing."

For developing countries, the final straw leading to the collapse of the talks came as the US refused to agree to proposals to allow them to adopt special safeguard mechanisms to help protect vulnerable agricultural sectors against sudden surges of agricultural imports and falling prices. At that point, it became clear to developing countries that no deal would be better than a bad deal.

The future of Fairtrade

Within the Fairtrade movement, opinion is strong on the need for rich nations to honour their commitment to deliver world trade rules that focus on promoting development. That would therefore mean an end to US and EU subsidies and to dumping in crops such as cotton, which are vital to developing country economies; it would mean opening US and EU markets to developing country exports, including by removing escalating tariffs; it could mean management of commodities as proposed by many developing nations, coupled with the right to protect their vulnerable agricultural and nascent industrial sectors.

Indeed, many in the movement hope that Fairtrade adds to the intellectual arguments for development-focused trade rules by providing a working alternative that does just that while still succeeding commercially. The suggestion is not that the precise rules of Fairtrade are applied globally, but rather that the principles of regulation for development gain currency. For in a world that is questioning the outcomes of unbridled liberalisation, Fairtrade shows in practice that there is another way to run trade. For this is not an abstract policy position – it is a reality being proven every day by thousands of producers, consumers and businesses worldwide.

And it is a citizens' movement, helping to build the momentum for change, creating the climate within which politicians can take the big, bold steps needed in world trade talks, giving them a mandate, confident that there is a large constituency crying out for fairer international trade rules. And, despite the credit crunch and mounting recession world-wide, the public appear to be staying loyal to Fairtrade. In the first half of 2007, sales of Fairtrade in the UK continued to grow at over 50%, while all research indicated that the public, having found out about Fairtrade and its impact for people overseas, intend to continue making Fairtrade first choice.

For example, a study by Ipsos MORI based on a poll of a thousand people in August and September 2007 found that, despite coping with tightening economic conditions, people are continuing to buy free range and fair trade which, the findings suggest, are the two categories best placed to survive the recession. Likewise, research reported in *The Grocer* in September found that, despite feeling the pinch, 92% of consumers still claimed to be willing to pay extra for a product perceived to be ethical.

Indeed, it may that Fairtrade is a serious solution fitting the serious mood of the times, and that the public in difficult times will come together around proven, positive solutions. As yet further in-depth research by PricewaterhouseCoopers with consumers and business concluded, the sustainability agenda is only set to grow: "doing nothing", they said, "is no longer a solution". Rather, like the internet, sustainability will become part of the way all companies do business and the smart companies will benefit by embracing the changes ahead of the game.

For the shocking reality is that today some 2 billion people worldwide still earn less than $2 a day – and too many millions of them are growing commodities exported to the West. Visiting Malawi recently, I was struck again by the urgency of the need – and the potential. Malawi is the world's fifth-poorest country, with a life expectancy of just 37 years. Tobacco aside, Malawi's main exports, providing livelihoods to millions, could be Fairtrade: tea, nuts, sugar, cotton, soya, lentils ... all commodities where prices have been in systemic long-term decline in real terms for the past 40 years – and in which the recent improvements are like a small tick at the end of the long falling downward line on the graph.

Many smallholders there are well organised but need access to market at fair prices. One tea smallholder told me that she could keep her children in secondary school only if she went without her main meal. That is why our teabags are give-away cheap. If we implemented a genuine "development round" of trade talks and if we scaled up the demand for Fairtrade – if we switched a significant chunk of the tea or peanut markets, for example, to Fairtrade – then the impact in Malawi could be transformative, triggering a virtuous economic cycle. For each farmer who receives a fair price spends locally and so generates opportunities for other local people, as well as for investment by producer organisations in infrastructure such as roads, schools or electricity that benefit whole communities and open new futures.

That is the vision that informs the Fairtrade Foundation's new strategy. We have plans to enable more producers to sell more of their crops as Fairtrade: to open up whole new areas, from jute and silk to cosmetics and seafood: to deepen people's understanding and change their purchasing habits; and we want companies to commit more seriously to Fairtrade, deepening their engagement with the producers. Of course, Fairtrade is only one piece in the jigsaw that we all need to put together to tackle poverty. But it is one piece in which each and every one of us can play a part – and to deliver which we need to keep our nerve during these difficult economic times, and keep innovating and investing in building a more robust and a fairer way to manage international markets.

Chapter 8

The case for consumerism

Ed Mayo, Chief Executive of Consumer Focus

The case for consumerism

We are all consumers, but not all of the time. We are also all members of families, communities and citizens of nations, perhaps the world. Do these roles that we have clash?

Critics of consumerism suggest not only that these roles are in tension, but that the problem is at root the extent to which our lives are now lived as consumers in the market. We live, in short, in an uncaring, unequal world. I agree that there are deep tensions. But, coming from the consumer movement, I am more hopeful that the most creative and innovative solutions that I see coming through are connected with people's lives as consumers rather than being stifled by them.

Michael Young, founder of the first National Consumer Council, predicted in the 1970s the rise of the consumer agenda and the politics of identity rather than class as the foundation of social change. In fact, there must have been something in the air for consumerism at the time. The origins of many of the most inspiring examples of ethical action lie in the 1970s. The first fair trade initiatives started. Ethical banking made an appearance with the new legal form of credit unions and Britain's first social bank. The first ethical investors in the UK stumped up money to put into worker co-operatives. And alternative technology was born, launched by the enthusiastic readers of *The Observer* newspaper.

Ahead of its era

These pioneers were engaged in the struggle faced by all concerned with social change, which is to run ahead of your own era, and to create new possibilities. The boundaries of the day were drawn by ideology and the great clash between communism and capitalism. Instead, their focus, reminiscent of the early co-operators in the 18th century, was on creating a politics of the everyday. While radical artists such as Joseph Beuys were turning ordinary objects into art, the ethical consumer pioneers were turning them into activism.

As Rob Harrison, Terry Newholme and Deirdre Shaw demonstrate in their overview *The Ethical Consumer*,[1] mainstream business was slow to adapt to the opportunities of ethical consumers. Initial leadership came from the margins – the ethical minnows, the small firms and social enterprises connected to the consumer communities that sustained them.

The first ethical unit trust, for example, was launched in June 1984. The fund was dubbed the "Brazil" model, because City analysts thought the idea was "nuts". The most optimistic

1 Harrison, R, Newholme, T and Shaw, D *The Ethical Consumer* (Sage, 2005)

predictions at the time were that the market would peak at only £2 million. Yet today investment in ethical unit trusts has surpassed the £4 billion mark. With a further £200 billion invested in pension funds that incorporate some degree of ethical screening into their investment strategies, the ethical investment sector could well dominate the market within the next decade.

Ten years later, the first product with a "fair trade" label appeared on the shelves. The mark guaranteed that what you bought was produced by people in decent conditions, and that they got a fair share of what you paid. I was involved in setting up the Fairtrade mark and I remember a supermarket chief saying he wasn't going to stock Fairtrade goods, because "only vicars would be mad enough to buy them". Well, vicars did. But so did many others.

From these beginnings, there are many markets in which ethical consumers have had a significant effect – from animal testing and lead in petrol through to organics and animal welfare in farming. Ethical consumerism has grown to be a force to reckon with.

New challenges for ethical consumerism

But there is no question that the field has to grow up again, if it is to find opportunities for activism that live up to the wild facts of environmental deterioration and global injustice.

A new swathe of responsible businesses has recognised the potential of ethical consumers, and has played a significant and undeniable role in its advance, in fields as diverse as sustainable forestry and anti-racism. And yet the discovery by commercial giants is also leading to shallow, "ethics lite" products, stripped of their values and their transformative power, and with the potential to confuse consumers already baffled and bamboozled by an overload of information and assurance.

Perhaps the real test will be the challenge of sustainable consumption. There are many pioneering initiatives in this field, and the successful ones could yet shape tomorrow's society and economy. But when environmental damage rises lock-step with what you spend, what you spend cannot save the environment.

Twenty years on from the pioneering book *The Green Consumer* by John Elkington and Julia Hailes,[2] consumer action is attracting growing attention, from celebrity endorsement of low-carbon cars, the use of organic cotton by fashion designers, and the Red label (raising global funds to tackle AIDS) championed by entertainers, through to a range of

2 Elkington, Hailes, J and Makower, J *The Green Consumer* (Penguin, 1990)

imaginative "how to make the world a better place" books and columns in the media. Politicians are on the bandwagon – and why not? – with micro-generation and grey-water recycling in their own homes.

Of course, this remains, on balance, a minority activity. But it would be wrong to conclude that people's ethical and environmental concerns do not matter to them when they are out and about as consumers. The truth is that the complexity of information required to make a judgment on product sustainability can leave even the most dedicated green consumer confused and disempowered. Our concern ought therefore to be how sustainable lifestyles can be taken up, perhaps in new ways, by the mainstream of society.

There are real challenges in doing this. As shoppers, we have more options than ever before. If we selected one of every item in a typical large superstore, we would have over 25,000 different products in our shopping trolley. Because we cannot weigh up the pros and cons of every single one, it is natural that we use decision-making shortcuts: price, branding, promotions, shelf position and packaging. For most, these shortcuts form the basis of a shopping routine that does not easily accommodate wider concerns. As one consumer told us, "The only problem is you can have so many labels on the products that it gets so confusing for the people that are buying things ... and all they do is they put the price up."

In considering consumerism, therefore, it is important to see people as they really are – in the round. This is where critics of consumerism can go wrong. The commentators that reject an economic model that paints people as purely self-interested "utility maximisers" are the people that criticise consumers as if they do conform to this model. We should never write people off or out of the picture in terms of what they can do in their everyday lives.

The role of young people

In research for *Consumer Kids*, a book to be published in 2009 that I have co-written with Professor Agnes Nairn, I have looked at how young people, while increasingly targeted by high-volume, intrusive marketing, are also showing the way for new forms of consumer activism.

Young people have been passionate advocates and in the vanguard of the cause of fair trade. Some 50,000 young people, for example, have signed up to "change the world" through Fairtrade as "Double Agents". Each spring, Fairtrade Fortnight acts as a focus for supporters, and over the years schools have become a key point for action.

In 2006, for example, 11- and 12-year-olds David Williams, Samantha Aspinall and Emma Kinley, from schools in Liverpool, joined up with 400 other schoolchildren who took part in events to develop a Chocolate Manifesto – a set of demands for a fairer deal for the families making chocolate. One of those involved said, "I think it is unfair that people aren't paid for the work they do to make chocolate and we just take it for granted." Another, Kyra, commented online later: "I love chocolate and I think it is unfair for the people that make such yummy sweets to not be paid fairly!!!"

The Chocolate Manifesto, developed by children, is surely a more sensuous and appealing name for an act of politics than any that adults have come up with since the Boston Tea Party. In terms of content, it talks to the issue of fair shares in world trade. In the classic classroom test of "Who gets the money?", an image of a chocolate bar or a banana is sliced up to see how much the taxman takes, the marketing costs and the growers get – and the growers always seem to get a pittance.

Thanks to Comic Relief, we know what this looks like in the mind of a 12-year-old. He or she estimates that, for a £1 chocolate bar, 23p goes to the cocoa growers in the country where it was grown. In a fairer world (and a 12-year-old would part with quite a bit more pocket money to make that come about), growers ought to receive three times that. The true answer for the £1 chocolate bar is that growers probably receive around 5p, and most of that covers their costs rather than representing net income. Turning your school into a fair-trade school is a fair way of responding to this. The school, to pass muster, has to make a series of commitments, such as including issues of trade and poverty in what is taught and trying to use fair-trade produce, from food to footballs.

In a number of schools, like Thomas Tallis in Kidbrooke, south London, children themselves run a fair-trade stall. On cold winter mornings before school starts, alongside the dilapidated but well-loved mobile classrooms, the bestseller by far is fair-trade hot chocolate. Schoolchildren are using such methods to sell not just fair-trade food, though, but sports stuff – and even, in Oxford, fair-trade school uniform.

As part of a Channel 4 TV documentary, *Teen Traders*, 14-year-old Martha Schofield from Cowley went with friends on the school trip of a lifetime, to India. There she visited factories to see how shirts were made. She came out convinced that there was a huge difference between doing things the commercial way and doing it the fair-trade way. "Many of the workers had become ill in the commercial factories from the pesticides used and they were working 12-hour days for tiny amounts – the equivalent of about 35p." She decided to make contact with one of the fair-trade outlets to see whether they could produce shirts that could be sold as the standard uniform for her school, Cheney School in Oxford. With school friends, she is selling them now.

Fair trade is one example, perhaps, of how young people have responded to the commercial culture around them by championing a different kind of commercial culture that they can own. One in four young people do boycott goods they disapprove of, but they have also moved beyond this. Their style of citizenship action is to hijack the consumer language and tools of branding and marketing for ends that they can believe in. Consumerism, after all, can be a force for good, and the power of the consumer movement is the idea not that you can do everything through what you buy, but that you can do something.

The ill-fated Doha round of world trade negotiations, the credit squeeze in capital markets, and the distant dealing of global corporations do not inspire confidence in the future global economic governance, let alone its ability to reconcile these to the wild facts of social inequality, climate change and, indeed, habitat loss for nature's diversity.

It is too large a claim to say that children could do a better job of it, but what may be true is that enlarging the circle of the public interest, which is a prerequisite for progress around all these policy dilemmas, can only learn from the wellsprings of civic activism such as ethical consumerism among young people. Opening up the institutions of economic governance – from the World Trade Organization to financial regulators – to civic engagement and transparency is an urgent call, because we need better process to get better outcomes and a fair trade world.

Consumer Focus, which campaigns for a fair deal for consumers, is Britain's new consumer champion and has been formed as part of a merger between the National Consumer Council, energywatch and Postwatch.

The Smith Institute

The Smith Institute, founded in the memory of the late Rt Hon John Smith, is an independent think tank that undertakes research, education and events. Our charitable purpose is educational in regard to the UK economy in its widest sense. We provide a platform for national and international discussion on a wide range of public policy issues concerning social justice, community, governance, enterprise, economy, trade, and the environment.

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