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Trading Up

Shanker A. Singham

AFTER DECADES of progress, the process of trade liberalization seems to be in danger of grinding to a halt. Both the political elite and average citizens express waning enthusiasm for freer trade. The World Trade Organization's (WTO) Doha Development Round, which seeks to improve trade terms for developing countries, has yet to produce significant breakthroughs and has now missed countless deadlines. Anxious publics, in developed and developing countries alike, perceive that liberalization and globalization have brought insufficient benefits. Rather than recognizing that such problems arise from domestic regulatory barriers to further liberalization, consumers fault global economic integration. When this misguided economic frustration finds political expression, publics elect populist candidates who promise some form of economic nationalism or mercantilism.

Venezuelan President Hugo Chávez is one leader who has successfully manipulated public preoccupations about "foreign exploitation" and economic insecurity. "We have buried Adam Smith", he triumphantly announced in 2006. Chávez may be at the forefront of the economic-populist trend, but he is hardly alone. Ecuador and Bolivia have notably taken turns towards economic nationalism, as have some of the developing countries in Eastern and Central Europe.

The leaders of developed countries may not have followed Chávez's lead in attempting to re-inter the long-deceased champion of free markets, but they too have embraced the rhetoric of economic nationalism. In France, President Nicolas Sarkozy has promised sweeping economic reform, although he has exhibited protectionist impulses in the past. As finance minister, Sarkozy approved of the government's disbursal of favors to French firms designated as "national champions." In the United States, several Democratic candidates have railed against the president's free-trade agenda (describing themselves as supporters of "fair trade").

In all of these examples, both consumers and their leaders have failed to recognize that domestic economic liberalization, not higher barriers to trade, will spur the economic progress that, in turn, generates jobs and prosperity. When previously protected sectors of the domestic economy are exposed to greater international competition, it is true that specific groups of individuals—tied to relatively

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uncompetitive industries—may suffer. However, as long as these industries receive protection from foreign competition, consumers that purchase these industries' products must pay higher prices than they would in a more competitive market.

While freer trade can cause economic pain in the short run, international competition allows countries to specialize in the industries in which they have a comparative advantage in the long run. Ultimately, trade and specialization benefit a diffuse group of consumers by lowering prices of many goods and services. Trade—to quote Federal Reserve Board Chairman Ben Bernanke—allows countries to "transform what [they] have into what [they] need or want under increasingly beneficial terms." Trade liberalization, in spite of the economic dislocations it may create, is not a zero-sum game. The entry of foreign firms, products and services into the domestic market—an inevitable consequence of trade liberalization—need not be feared: It benefits the average consumer.

Free or Fair?

YET BOTH economic nationalists (some of whom are both against free markets and free trade) and fair traders are not convinced that freer trade is a desirable goal. Both concentrate on trade liberalization's perils, though fair traders often frame the issue in social-justice terms, rather than simply positing a link between restricted trade, job protection for domestic workers and a healthy domestic economy. Free trade's opponents note that a purely market-based approach to trade will have "unfair consequences" if domestic regulations—such as labor rules, internal taxes or laws affecting international distribution—between the trading partners differ. Unfortunately, the fair-trade approach is not the cure-all that its advocates claim it to be. Fair-trade policies undercut comparative advantage, the foundation of trade theory. If trade is only "fair" when domestic regulations in developing countries are identical to those found in developed countries, or if trade is only fair if labor costs are the same, then developing countries—which rely on low labor costs for continued economic growth—would be especially hard-hit. Thus, a new definition of "fairness" is needed—one that captures how domestic-market conditions affect international-trade patterns.

Publics that are skeptical about trade liberalization's benefits often presume that it is impossible to compete "fairly" on the world's economic playing field. As noted earlier, this current concept of fairness does little to truly level the field—and may even be detrimental to economic growth and consumer welfare. If trade liberalization is to continue, the term "unfair" must be applied to restraints and regulations that hinder competition—not the concept of competition itself. These "unfair", anti-competitive policies distort consumer choices, to the detriment of consumers and to the benefit of specific firms or industries. It is the anti-competitive restrictions on market activity, not trade liberalization, that impede economic growth and prevent the gains of trade from spreading to consumers.

One only needs to look at the WTO-mediated telecommunications dispute between the United States and Mexico to grasp the deleterious effects of the lack of competition. In 2004, the WTO concluded that Mexico's International Telecommunications Long Distance Rules unfairly disadvantaged U.S. telecommunications firms. These anti-competitive rules allowed TelMex, Mexico's principal telecommunications firm, to charge both U.S. and Mexican consumers artificially inflated prices for calls placed to and from Mexico. Estimates indicate that the anti-competitive rules cost U.S. consumers alone an extra one billion dollars be-

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tween 2000 and 2004. Instead of taking the interests of Mexican consumers into account, the Mexican government used domestic regulations to benefit local producers.

Firms that benefit from anti-competitive restrictions are quite distinct from firms that simply make efficient use of their inputs. A firm that benefits from an "unfair" legal environment is at least partially shielded from competition, so it has little incentive to cater to consumer preferences. The offerings of the American automobile industry while it was protected from Japanese competition serve as unfortunate reminders of this phenomenon.

On the other hand, a cost-effective firm operating in a competitive environment will oblige other firms to engage in competition for profits. When these firms struggle for dominance, basic economic theory states that the average consumer benefits, usually in terms of lower prices for goods and services. Such highly competitive markets, though beneficial to consumers, are difficult to create in practice.

Moving from an "unfair" domestic market towards greater competition is a slow, politically fraught, easily derailed process. Firms that have much to lose from economic liberalization—like some of America's textile producers—will lobby to protect their interests. Meanwhile, the vast mass of consumers cannot effectively organize to counteract the influence of these industry-based interest groups.

When domestic economic deregulation is thwarted by such political maneuvering, the gains from trade liberalization become less apparent to consumers. Domestic regulation hinders the ability of foreign firms to enter what should have been an open market, so consumers in that particular market are unable to benefit from increased competition among firms. Instead of faulting domestic economic policies, consumers blame liberalization and globalization for the lack of improvement in their material circumstances.

Since the public does not recognize the connection between trade and domestic-market competition, it gives its support to leaders who enact crowd-pleasing but economically unsound policies. This scenario is almost a vicious cycle: When populations perceive that trade liberalization has not benefited them, they clamor for anti-competitive economic policies. When these domestic policies are enacted, they further prevent the disgruntled populace from benefiting from integration into the global economy.

SO WHY has the link between domestic regulation and trade liberalization been ignored during the formulation of international trade policy? This can be at least partially explained by the overwhelming producer bias in trade-policy negotiations. The fair-trade-versus-free-trade debate merely obscures the true dichotomy in trade: a producer-welfare orientation versus a consumer-welfare orientation. If consumers are to derive greater benefits from trade liberalization, trade-policy discussions must adopt a more consumer-oriented perspective.

A producer-welfare orientation sees only producers that make products in one country and that sell those products to people in another country. It is in the interests of these producers to block import competition in their home markets while securing market access abroad. Ultimately, this is a purely mercantilist outlook. This kind of approach leads to economic nationalism and protectionism, in which the state plays an ever-increasing role in the economy. It is a zero-sum world, where borders are important and consumers are not—and where people are encouraged to view themselves only in their producer roles.

A consumer-welfare orientation puts forward an opposing view: Trade is not

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a zero-sum game. The consumer orientation operates on the premise that the modern world is not one in which producers export goods from one country to another; rather, it is a world of closely connected global supply chains for goods, services and people. This is a world where national borders are less meaningful (with all that that entails for immigration policy and cultural identity). In this model, businesses are consumers too, so they also benefit from reduced prices. A consumer-oriented approach, then, calls for reductions in import costs for exporters, as well as for producers who sell their wares primarily in the domestic market. Cost reductions lead to greater efficiency and greater global-supply-chain integration, ultimately leading to lower prices for a product's final consumers.

Embracing a consumer-oriented perspective will require action on both the domestic and international planes. At the domestic level, countries should ensure that market-distorting regulations and activities—like government grants or preferential loans to certain firms—play minimal roles within national borders. Countries that do not have laws enshrining competition should create and enforce them via domestic competition agencies. These laws must be carefully crafted so that they effectively cover both private- and public-sector anti-competitive actions. If such laws are to serve their purpose, domestic competition agencies must not try to design outcomes for these markets or act as overzealous regulators. Instead, they must facilitate freely competitive markets and intervene only when there is failure.

At the international level, trade negotiators must change their tactics, as the producer-oriented method has run out of steam. For the last half-century, trade negotiators have focused on the needs of producers in reducing trade barriers, cleverly harnessing the forces of mercantilism to craft cross-cutting agreements. Now, however, the producer-oriented approach's mercantilist rhetoric cannot effectively combat the domestic anti-competitive regulations that act as barriers to trade. The stalled Doha Round negotiations—and the lack of corporate concern about its eventual outcome—demonstrate that the days of furthering trade liberalization by trading off producer interests are over.

Trade negotiators must acknowledge the reality of modern trade negotiations. They must recognize that concentrating on competition and consumer welfare will benefit their respective economies, since producers are also consumers. Negotiators must embrace a consumer-oriented dialogue in order for domestic-market impediments to trade liberalization—anti-competitive legislation and regulation, and general government interference—to be removed.

IN ORDER for the consumer-welfare orientation to inform trade negotiations, policymakers must factor notions of competition into their decisions. Yet so far, the link between competition and trade has had a checkered history at the WTO. Although competition underpins much of trade theory and is enshrined in a number of WTO agreements, developing countries rejected a formal competition-trade nexus prior to the 2001 launch of the Doha Development Round.

The developing countries' opposition to the competition-and-trade agenda stems from objections to the WTO's dispute-resolution mechanism. The WTO's dispute-resolution procedures mandate that a state accused of erecting illegal barriers to trade may face various penalties, including sanctions, for failing to uphold its WTO obligations. A product of the WTO's Uruguay Round, the current dispute-resolution process is intended to evenhandedly enforce the organization's trade-liberalization agreements in a legal and non-diplomatic manner. Yet

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developing countries are concerned the dispute-resolution mechanism and its associated competition rules actually favor developed countries. Developing countries allege that these competition rules represent a disguised way of achieving market access, violating their national sovereignty.

In light of developing-countries' distaste for the dispute-resolution process, other methods of promoting competition in domestic markets—and thus creating the conditions for freer trade—must be explored. WTO member states should consider public-sector restraint disciplines, in which signatory countries promise to curb anti-competitive, trade-restricting regulation and to apply the competition rules that govern private-sector firms to their state-owned companies as well. The EU's state-aid laws, which prevent certain types of government assistance to private companies, could serve as a starting point, as could more recent attempts to scale back the anti-competitive state-action exemption in U.S. antitrust law.

To convince developing countries to approve public-sector restraint agreements, these pacts could be implemented without resorting to the current dispute-resolution process. A very limited dispute-resolution mechanism might be feasible, but, barring that, other workable alternatives exist. The General Agreement on Trade and Services—which brought trade in services under the WTO's watch—contains competition disciplines that prescribe consultations, rather than impose trade sanctions, to settle disputes. A peer-review mechanism, akin to the Trade Policy Review Mechanism (TPRM), presents another option. The TPRM allows for the monitoring of WTO members' trade practices and policies, inspiring increased observance of WTO mandates.

A new or revised dispute-resolution process could incorporate input from domestic competition agencies, giving the competition "notion" greater credibility at the domestic level.

Since the current dispute-resolution mechanism cannot be applied to these agreements, they must be self-enforcing. That is, governments must want to abide by the agreements because it would harm their reputations, domestically and internationally, to do otherwise. Self-enforcing agreements might be more viable if trade negotiations take a consumer-oriented perspective. Governments could only object to an agreement on the basis that they wanted to reserve the right to harm their own consumers. Such a position would be politically difficult to take, particularly if the country's negotiating partners used the deviation from the agreement as a bargaining chip.

In addition to formulating disciplines to deal with anti-competitive public-sector restraints, WTO member countries should attempt to bolster the credibility of domestic competition agencies. These agencies are crucial to promoting freer markets, as they can contest the consumer welfare–harming, anti-competitive regulations that function as barriers to trade. Unfortunately, in many countries, these agencies are unable to face down the powerful groups that have benefited from the lack of competition. Public-sector restraint disciplines or agreements, by eliminating certain anti-competitive domestic regulations—and therefore unlocking consumer welfare–enhancing market forces—will help build the external credibility of these agencies.

PERHAPS MORE significantly, public-sector restraint agreements enhance the credibility of competition organizations because these agreements bolster the credibility of *all* domestic economic institutions. In developing and emerging markets, where economic institutions are weak, these agreements could prove to be especially significant to continued economic

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development. Robust institutions, many scholars believe, would enable economic growth to reach a wider segment of the developing countries' populations. If economic growth touches wide swathes of the populace in the developing world, a competition and market culture could take root there. If the institutions in this part of the world are made stronger, conventional wisdom suggests the developing world might actually develop.

Currently, institution-strengthening is a top-down affair. Large amounts of development money are directed towards this effort, and much energy is expended training officials that will man these institutions in the future. Yet this approach is incorrect, as institutions cannot simply be constructed and then expected to work properly immediately.

Institutions, in the economic setting, are ways to channel the very real forces of competition and the market. There can be no strong or robust institutions unless the restrictions on the free flow of those forces are removed. Only when these forces are liberated can the resultant consumer empowerment support the building of strong institutions. In many ways these forces are at the core of building functioning liberal democracy. Elections or institutions built from the top down will not lead to the unleashing of these forces; indeed, both will simply become corrupted by the very obstacles to the proper operation of the market.

To assume that functioning markets will flow from elections is to put the cart before the horse. Institutions do not create markets. Functioning markets produce, by necessity, robust institutions. Institutions are created and strengthened by their continuous exposure to the winds of competition and the market. It is these forces that operate on man-made institutions like the wind on a rock face, giving them resilience and strength. By fortifying economic institutions, public-sector restraint agreements would also help to restore public faith in the market's ability to encourage economic progress.

THE INCREASING interplay between trade and competition has rendered the existing producer-oriented trade-liberalization dialogues obsolete. If competitive markets are to be allowed to flourish, and if regulatory reform is to occur, domestic politicians and trade negotiators must adopt a fresh, consumer-oriented perspective. This consumer-oriented approach to trade liberalization would allow a new trade dialogue to occur between those who advocate for exporters (typically trade ministries) and those who advocate for domestic consumers (typically competition agencies). Instead of a dialogue of the deaf between two opposed trade ministries arguing their own mercantilist logic, this new discussion would seek to achieve the maximization of consumer welfare. Such a discussion would be more likely to produce meaningful results and would more completely satisfy the underlying purposes of international free trade.

A consumer-oriented dialogue is more appropriate for the real world of international trade in the 21st century. Our 21st-century world is one of competing global supply chains and decreasing costs—a world where the consumer, more than ever before, is king. □

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