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Poverty and Globalization

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MOST OF the world's people live in countries where markets do not work properly and resources are not efficiently allocated. The notion that liberal economics has "failed" misses the point that in many areas of the world it has not really been tried.

Poverty—often cast as the fault of multinational corporations or "imperialist governments"—is the most virulent killer on our planet. Many continue to believe that increased government regulation and control, particularly when it comes to international trade, is the best way to combat poverty, ignoring the fact that real liberalization—truly free and competitive markets—is in fact the agenda of the world's poor.

It is therefore ironic that efforts to ensure that markets are competitive often fall on the sword of "national interest." Alleged threats to sovereignty are often cited by countries as reason not to negotiate on matters that touch domestic regulation and policies. In practice, this means that they reserve the right to maintain the status quo in which local producer interests trump consumer welfare. Allowing such notions of sovereignty to dominate over economic empowerment of people is to consign the vast majority of citizens to poverty.

It is remarkable that one of the most effective vehicles for empowering individual citizens—global trade negotiations—has largely disregarded this pivotal element of its work. Trade discussions have long centered on enhancing the welfare of producers, rather than on empowering consumers, despite the fact that the fundamental principles on which trade agreements are based are consumer-welfare enhancing ones. Today, the divide between those who would adopt a more consumer-led approach to market-opening and economic growth and those who maintain a producer-led focus represents a major factor opposing free trade and contributes notably to the stagnation of the international trade agenda.

One of the main problems is that governments and elites have refused to recognize the most basic fact of economic life: We are all consumers. Even businesses are also consumers of raw materials or finished or unfinished products. Yet trade negotiations are conducted with a strong bias toward mercantilism. It is quite revealing that in trade talks negotiators continue to refer to tariff cuts as con-

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cessions, as if lowering a tariff requires a "payment" by one's trading partner. This mercantilist logic is now applied to a whole raft of rules-based negotiations. Countries that employ this approach are really saying that they reserve the right to harm their consumers so that producers may receive a benefit in some unrelated area. This is irrational and destructive economics, which if not rooted out will perpetuate misery for billions of people. The recent Eminent Persons' Report prepared by a group chaired by former WTO Director General Peter Sutherland offered an opportunity to redirect the mercantilist approach toward trade. Sadly, however, the word "consumer" never appears in the text of that report.

Because so little attention was paid to consumer welfare, the unprecedented amount of trade liberalization that occurred in the 1990s did not lead to the competitive markets as had been predicted. At first this lag went unnoticed by trade negotiators from major developed countries, such as the United States and the EU countries, where competitive markets were much more the norm. The assumption was that removing trade barriers would inevitably lead to competitive markets inside the border.

But these negotiators failed to factor in the decades of state control and import-substitution economics that had pervaded most of the world's markets. In this context, removal of at-the-border barriers, which were often accompanied by significant privatization programs, often only enriched the gatekeepers, who initially invested in the privatizations at the expense of new entrants. Consumers in countries with low levels of competition were not always empowered by an opening to trade because the prices they paid for products were determined not by tariffs but by levels of competition in the market, which had not changed. The result was an increase in the perceived—and actual—disparity of wealth between the gatekeepers and consumers while poverty persisted. So instead of reacting by advocating more competitive markets and greater pro-competitive regulation inside borders, consumers questioned the entire process of liberalization itself.

Reform Fatigue in Latin American

IN LATIN America, the reaction has been so pervasive that one would be hard pressed to find anyone in the region who would not agree that the privatizations and liberalization of the 1990s had been a costly failure. Few would identify that failure with a lack of competitive markets, but they are linked. In many cases, public monopolies with regulation were simply converted into private monopolies without regulation. In other situations, laws were left on the statute books that not only tolerated but actually mandated anti-competitive conduct by private parties, such as laws that prevented foreign suppliers from severing relationships with failed distributors or taxes that discriminated against new market entrants, especially through foreign investment.

Today, the economic environment in many countries in Latin America and the Caribbean is dominated by two conditions: fatigue and fear. We talk about societies inflicted with "reform fatigue": They are tired of dealing with economic reforms that fail to fulfill their promise of growth and development. And we lament studies that show many Latin Americans and citizens throughout the Caribbean, some of whom lived under authoritarian rule and military dictatorships just twenty years ago, are today also tired of democracy—tired of a system of government that guarantees free and fair elections at regular intervals but that brings no concrete benefits in between.

It's easy to see why many societies in our region are experiencing reform fatigue. Today in our hemisphere, after over a decade of supposed free market economics and democratic government, there are still eighty million people who live on less than $2 per day. For these eighty million people, all the political and economic reforms have been largely meaningless.

This fatigue with reforms is dangerous, because when countries, peoples and societies are tired, they often opt for the easy way out. Today, there is a new wave of populist leaders—from Hugo Chavez in Venezuela to Nestor Kirchner in Argentina to potential leaders like Evo Morales in Bolivia—prepared to offer that alternative. Their rhetoric varies somewhat from country to country, of course, but the message at its core is that those who are poor find themselves in that circumstance because others are rich—because the pie of prosperity is only so big and someone has taken your piece. And the only way to change the status quo is to cut the pie a different way, to take your piece back. That view also figures in the populists' foreign policy, which holds that the developed world has grown rich only through the exploitation of other countries and that the emerging world is poor because of that abuse.

While overly simplistic, these claims deserve serious examination, because they contain a kernel of truth. They accurately describe the zero-sum game that has too long distorted reform initiatives and liberalization. Too often there have been cozy arrangements between the political and business elites that have ignored the welfare of the majority of the people. One example of this is the much-studied Mexican telecommunications sector, which has recently been the subject of a WTO case for anti-competitive post-privatization practices. Another example is the plethora of dealer-protection laws around the hemisphere, where it is almost impossible for foreign suppliers to terminate their local distributors, because the laws effectively mandate that supplier-distributor relationships go on forever. This chokes off competition at the distribution level and leads to rent-seeking behavior by the gatekeepers of the economy, in this case the local distributors. As a result of such laws, the prices of some basic products are kept artificially high. In the case of medicines in some countries, local distributors have been able to maintain 100 percent profit margins. Indeed, there are examples of local distributors refusing to allow suppliers to make charitable donations, claiming that such an act would effectively terminate the agreement between them and trigger the very high termination indemnities under these laws. The financial benefits that these gatekeepers acquire are then ploughed back into the system in an effort to preserve the anti-competitive regulation. There are also examples of privatization that merely lead to an uncompetitive and uncontrolled private monopoly, as opposed to a state-controlled and sanctioned one, largely because of the focus on government revenue generation. Even in the UK, where the privatization experience has been more pro-competitive than most, initial electricity privatization did not result in enough competition at the generation level and caused competitive problems downstream. Rarely is there a focus on unleashing the forces of competition. Privatization, countries have learned, does not automatically lead to a competitive market. That depends on the quality of the domestic regulatory system.

The oft-quoted remark that there are winners and losers in free trade unfortunately reinforces the idea of a zero-sum environment by suggesting that if someone is winning, someone else is losing. Positing the idea that someone must end up on the zero side of the free trade ledger engenders fear. The fearful believe that, in this new world, they will not be able to compete. A good example of this is the resistance in some Latin American countries, notably Ecuador and the Dominican Republic, to a competition law. Viewed through the lens of producers only, local producers do not want to face competition in their markets and do not want to change their customary practices, however damaging those practices are to consumers. But competition can benefit local producers also. Viewed through a consumer-welfare lens, even small businesses, which often buy raw materials for their productive processes, would benefit enormously from more competitive practices at this level.

Strengthening Competition

IN THE current discourse, we have tended to classify countries into those that espouse free market economics with all its implications, and those that favor central control or greater government interference. In weighing their policy options, few countries look at microeconomic policy through a consumer lens.

The current model for trade negotiations is for all partners to defend their producer interests, which almost inevitably clash, leading to an impasse in the talks or, as in the case of negotiations to create the Free Trade Area of the Americas (FTAA), to such a limited set of objectives that the goal of free trade is virtually set aside. In the case of the FTAA, before negotiation stalled completely, some countries, led by the Mercosur trade bloc, resisted the notion that the trade agreement should cover more than traditional border measures and reach into the domestic regulatory measures in states. Attempts to introduce a consumer-welfare-oriented competition policy or to protect intellectual property rights were sacrificed to national sovereignty, as countries maintained that they reserved the right to have whatever domestic policies they chose. But this is a canard. International trade rules have already impacted domestic policy: A country's tariff law is itself a national law. What is really being said, in effect, is that they reserve the right to harm their own consumers or not to protect property rights. If this is indeed the claim, their own people should be aware of it.

To express more clearly the central importance of consumers, competition policy should be brought into the mainstream of trade negotiations. Competition policy must move from being merely an add-on to driving trade talks. Issues that affect the business climate in the target market—such as a country's rules on standards or the way it enforces intellectual property rights—are increasingly cited as legitimate topics for trade negotiators. It is also essential to ensure that the level of competition in the market is not itself a barrier to entry that would undermine the real goal of free trade. The principal benefactors of this approach will be consumers, who will have access to a greater variety of higher quality goods and services at lower prices and, not coincidentally, efficient producers capable of competing on a level playing field.

The last decade has seen an increase in the number of competition agencies throughout the world. Twenty years ago, the primary competition agencies were in the United States and Europe. There are now almost one hundred competition agencies in the world, including many in Latin America. These include agencies in Brazil, Argentina and Mexico, as well as in smaller countries, such as Costa Rica and Panama.

Unfortunately, the impact that these agencies can have on their local economies has been decidedly mixed. This is largely because they are dealing with the powerful entrenched forces noted earlier. They are also dealing, in many countries, with an environment that does not necessarily accept the notion that competition should be the chief economic organizing principle. And as long as many countries do not define "non-optimal" economic behavior as that which leads to harm to consumers, they are not in a position to ensure that the playing field will be level and that the rules of the game will apply to everyone.

Thus, we come back to the importance of international trade negotiations. By incorporating specific provisions regarding competition, multilateral trade agreements can enhance the external credibility—and the real independence—of domestic competition agencies. But more importantly, negotiators need to recall their primordial obligation within the trade system to construct and agree on rules that are more likely to lead to free trade and free markets, and to adopt a consumer welfare lens in their negotiations.

Despite the furor about introducing competition principles into the WTO, we should point out that it already does address competition issues in many of its existing provisions, both in the agreement that applies to goods and especially in the agreement that applies to services. However, there are some ways to link the level of competition in markets to liberalization processes. Tariff reductions by one side could be linked to the ending of public sector anti-competitive practices by the other side. This makes economic sense, since the benefits of these tariff reductions will be vitiated if there are anti-competitive public sector restraints in the market. Competition safeguards, which could be triggered by demonstrating anti-competitive practices by a government or perhaps a private party, could also be established. Additionally, there is a need for some kind of discipline over public sector restraints that are anti-competitive, akin to the EU's state aids provisions.

Such innovations in trade agreements would bring the interests of exporting companies and foreign investment into alliance with consumers in the trading partner. Local producers would no longer be able to dominate the debate about what is best for the particular country. We have intuitively known that local producers do not always speak for the best interests of their country—even Adam Smith stated that local producers were very good at proving that what was in their interests was in the interests of the country as a whole, when the opposite was often the case.

The principal benefactors of a new approach to trade liberalization would be consumers. While the WTO and World Bank have noted in studies savings of close to half a trillion dollars to the world economy if the Doha Development Agenda succeeds in substantial liberalization, little of that will accrue to consumers unless internal markets function competitively.

What Will It Take?

AT PRESENT, one cannot point to any country in the world that has fully embraced the cause of consumer welfare in its trade negotiations. It is often too difficult to ask trade ministries to see beyond the forces that their producer constituencies are exerting on them. Countries or specific economic sectors (since frequently countries are two-faced on these issues depending on which sector you are analyzing) often move back and forth between measures that protect producers and those that would empower consumers. While embracing certain aspects of free market norms, countries will advocate for old-style industrial policy in the building of national champions through government subventions. This occurs even in developed countries, such as France, where the government recently decided to list certain companies that are deemed strategically important and are therefore protected from foreign takeover. Recently, certain EU member states rejected the process of service liberalization within the European Union. The inventory of seriously liberalizing service offers from WTO members is bare indeed, even at this last stage of the game prior to the WTO's Hong Kong summit in December. Even postal privatization in Japan, which the overwhelming number of Japanese favor, became such a heated subject that it caused Prime Minister Junichiro Koizumi to dissolve Parliament when the reform was rejected there. What we see is countries trying to have their cake and eat it, too—good old-fashioned mercantilism—seeking better market access for their producers while resisting competition for their own markets. In addition, countries are seeking to adopt some aspects of the free market slate, particularly with respect to macroeconomic policy, while not adopting others, particularly in the microeconomic arena, or by adopting an industrial policy that favors the development of national champions (again, a producer-led vision). The problem is that in today's globalized world one simply cannot try to have a sound macroeconomic policy while tolerating or even encouraging the very practices domestically that will ultimately erode the path to economic progress. When governments try to intervene in markets to guarantee certain outcomes, the government subsidy or aid may distort the market in a particular sector, thus enriching one particular producer at the expense of consumers and even producers in other related sectors.

What we are witnessing now is the teasing out of these differences at the global level. China provides us a very good example of this—where the guiding economic principle is the "socialist market economy." Here, China is moving to a competitive market, complete with a competition authority, while at the same time operating in an environment with a large number of state-owned companies and corporate welfare. However, examples of this kind of picking of options from both sides of the consumer-producer ledger are certainly not confined to China and exist in many countries and many sectors. This is not a developed-versus-developing-world dichotomy, but rather a problem that plagues both developing and developed countries alike.

Clearly, open trade and competitive markets are just two of the factors required if the world economy is to grow and develop and to ensure that growth and development are sustainable and broad-based. In several public speeches, former U.S. Trade Representative and now Deputy Secretary of State Robert Zoellick has made the most skillful and inspiring case for free trade as an effective weapon in the fight against poverty. Speaking at the FTAA trade ministerial meeting in Quito, Ecuador, in November 2002, Zoellick said, "Our ultimate objective is not to have an agreement; it is not to increase trade. Our objective is to grow our economies, reduce poverty, generate jobs, offer opportunities and above all, to create hope." Indeed, free trade and competitive markets can convert the fears about the new economy into hope and the fatigue over reform into energy—if we will only use them to those ends. □