Initiative for Policy Dialogue Working Paper Series

September 2005

How to Open up Markets

Andrew Charlton and Joseph E. Stiglitz

Trade

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How to Open up Markets

The general argument in favor of trade liberalization is that it allows the expansion of the size of markets, allowing the global economy to take further advantage of the economies of scale (the argument Adam Smith put forward more than two-hundred years ago), and it enhances global efficiency in production and exchange. The factor-price equalization theorem stipulates conditions under which trade in goods and services leads to full global efficiency, substituting for the free mobility of factors. Those conditions are highly restrictive, and over the past several decades, discussions have moved from liberalization of trade to allowing for the mobility of *capital*, though not of labor. As noted earlier, the standard argument that trade liberalization necessarily makes all countries better off (though not necessarily all individuals within each country) is predicated on a set of assumptions that is not satisfied in most developing countries: full employment, perfect competition, and perfect capital and risk markets.

Labor mobility and unskilled labor-intensive services

The General Agreement on Trade in Services (GATS) recognizes four modes of service delivery. The temporary movement of natural persons (so called Mode 4 service delivery) has received by far the

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smallest attention in terms of the volume of scheduled concessions. Yet differences in factor payments across countries provide evidence that factor movements would substantially increase global productivity. If factor payments equal marginal products,[1] then the largest discrepancies are associated with the payments to unskilled labor, then to skilled labor, and lastly to capital. Accordingly, agreements that provide for the mobility of unskilled labor would do most to increase global efficiency.

Yet despite the tremendous development potential of this reform, the limited progress that has been made in this area has been largely associated with the intra-corporate movement of skilled personnel—an issue of interest to developed countries. Thus far Mode 4 has not progressed in a way that allows developing countries to use their comparative advantage in low- and medium-skill labor-intensive services. Nor has enough attention been given to proposals to facilitate remittances—the payments from migrant workers back to their families in developing countries. Governments have a role to play in maximizing both the value of remittances and their impact on development. Efforts to formalize the structure of remittance flow (much of which currently moves through informal channels) could make it easier, safer, and cheaper to transfer funds. For example, governments could ensure that migrants have access to secure and low-cost financial services and could regulate remittance-handling intermediaries to prevent malpractices. As well as increasing the flow of remittances, remittance policies can improve the development impact of remittances at the receiving end. For example, microfinance and micro-enterprise support initiatives have encouraged remittance-receiving clients (especially small businesses) to access credit and savings accounts.[2] Finally, the further development of remittance-backed bonds could help liquidity-constrained

[1] They may not, and the disparity between factor payments and the value of marginal products may differ across countries, if the degree of market imperfections differs.

[2] For an example of an initiative in this area see the case of the financial institution PRODEM in Bolivia, which focuses on the promotion of savings and the offer of new financial services to remittance receivers. See UNDP (2003*b*). A number of best-practice scenarios from Latin America and Asia were presented and documented in the November 2000 ILO conference in Geneva on 'Making the Best of Globalization: Migrant Worker Remittances and Micro-Finance'.

developing countries to use future flows of remittances to raise external finance relatively cheaply.[3]

As well as facilitating the movement of natural persons (Mode 4), there is scope for liberalization of other service industries of importance to developing countries. Services account for, on average, 50 per cent of developing countries' GDP, but developing countries account for only 25 per cent of the world's services exports. While the last decade has seen considerable liberalization of high-skill services, there has been less progress in those unskilled-labor-intensive services of interest to developing countries.

The liberalization of services could yield significant welfare gains to developing countries—indeed a large number of empirical studies suggest that service sector liberalization has the potential to deliver larger gains than agricultural or manufactured goods.[4] The estimates are large because protection levels are high in the service sector, and services make up a large (and growing) share of world trade. Additionally, services are key inputs into the production of almost all goods.

However, the large predicted gains from service sector liberalization have to be weighed against the relative complexity of service sector reform, where the identification and elimination of trade barriers is significantly more difficult than in merchandise trade. In particular, three concerns commonly arise. First, there is a view that only a small fraction of service sector reform is actionable through WTO negotiations. Second, several important elements of the reform agenda (particularly liberalization of restrictions on foreign direct investment within Mode 3 service delivery[5]) are successfully progressing through unilateral policy changes outside the WTO. Third, multilateral commitments within the WTO are seen by several developing countries as a particularly blunt instrument of

[3] In 2001, Banco do Brasil issued $300m worth of bonds through Merrill Lynch using the future yen remittances from Brazilian workers in Japan as collateral. The terms of these bonds were more favorable than those available on sovereign issues (with a BBB+ Standard and Poors rating compared to BB− on Brazil's sovereign foreign currency rating). For a review of securitization of remittance flows see Ketkar and Ratha (2000).

[4] See, for example, Hertel *et al*. (2000), Dee and Hanslow (2000), Brown, Deardorff, and Stern (2001), Francois, van Meijl, and van Tongeren (2003), Verikios and Zhang (2004).

[5] Mode 3 refers to trade in services delivered through foreign commercial presence, particularly foreign subsidiaries of multinational firms.

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reform, lacking the flexibility to deal with the country-specific implementation challenges thrown up by liberalization in the service sector. Together these concerns contribute to the continued low priority given to GATS commitments within the overall agenda. This is unfortunate because it undervalues the significant and growing service export interests of developing countries and also because it has drawn attention away from those policy proposals (scattered throughout the agenda) which could facilitate and improve the effectiveness of unilateral reform in developing countries.

Many developing countries have large and growing export interests which could be pursued in the Doha Round. The substantial growth in offshore outsourcing (Modes 1 and 2)[6] has led to high growth rates of exports from developing countries in particular business services[7] and ICT, but also in health, education, and audiovisual services. Barriers to trade in these areas include national authorization, local authentication requirements, and regulatory standards. There is significant scope for liberalization in Mode 1, which lags behind Mode 3 in terms of both the number and scope of commitments. The Uruguay Round left many areas of Mode 1 trade without bound commitments. A large proportion of commitments provided only partial market access (60 per cent in legal services; 78 per cent in voice telephone services; 41 per cent in accounting; see Matoo and Wunsch 2004). In several areas where developing countries have a comparative advantage there is a case for broad formulaic rules in favor of national treatment and increased market access.

At the same time there are other non-market access reforms which could complement service sector reform and increase the benefits available to developing countries. The tourism sector (Mode 2) is one of the most important sources of foreign exchange for many developing countries. While the sector is generally quite liberal in terms of government restrictions,[8] developing countries suffer from rampant anti-competitive activities within the industry which

[6] Service delivery through Modes 1 and 2 refers to cross-border supply and consumption abroad respectively.

[7] In India exports of business services grew by 43% between 1995 and 2000 (Matoo and Wunsch 2004).

[8] There has been a high number of commitments in major tourism sectors, in particular hotels and restaurants (123 members). See WTO (1999).

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minimize spillover and multiplier effects. In this and other areas (for example maritime transport), an effective multilateral anti-trust framework could deliver large gains to developing countries and support further unilateral liberalization.

The same is true in Mode 3 liberalization, where the enthusiasm for FDI in the cross-country empirical literature is tempered by negative experiences at the national level. While it is true that the unilateral liberalization of restrictions on foreign investment continues apace without multilateral action, there are nonetheless several opportunities for WTO action which could increase the benefits that developing countries derive from the liberalization of FDI. For example, developing countries' experiences with FDI could be improved by agreements to limit the adverse consequences of competition for investment through fiscal and financial incentives[9] and also by agreements to allow for anti-trust enforcement between jurisdictions.

Another problem is that in many cases, the ramifications of the particular measure extend well beyond the impacts on trade. Inevitably, then, debates about service sector liberalization devolve into fundamental debates about national economic and social policy. Is it right that the media, for instance, be controlled by a few rich foreign firms, who are able to use their wealth to control the flow of information to the citizenry? A further concern is that many service sector liberalizations might have social consequences for the poor, for example by increasing prices of essential services or by reducing access. Opening up markets has been accompanied at times by a reduction in competition, and an increase in prices;[10] in the case of financial services, there are even allegations that the supply of credit to medium and small domestic enterprises has been reduced. Private firms may be less willing to engage in cross-subsidization of market segments in poor and rural areas. Even if liberalization leads to lower average costs through increased competitiveness and efficiency, prices for some end-users may rise. The WTO could promote service

[9] For a discussion of harmful tax practices see OECD (1998). For welfare losses from international tax competition see Charlton (2003).

[10] For example, privatization of utilities—such as South Africa's experience of granting its newly privatized telecommunications utility Telekom a 5-year monopoly—can lead to inefficient services. Similarly the poor regulation of financial sectors across South-East Asia contributed to instability prior to the crises of the late 1990s. Poor electricity deregulation has led to problems in many countries.

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sector liberalization by acting to mitigate (or at least not exacerbating) these concerns through other parts of the agenda. For example, regulatory agreements which constrain the ability of governments to avail themselves of appropriate industrial, social, and redistributive policies might reduce the incentive for governments to engage in liberalization programs which entail adjustment costs.

Service sector reform offers large benefits to developing countries but is not receiving commensurate attention in the Doha Round. However, there is much to be done within the WTO to unlock welfare gains from service sector reform, including pursuing the developing countries' market access agenda in labor-intensive and outsourced services and promoting reform in other parts of the agenda to amplify the benefits of service sector liberalization and limit its costs.

Agriculture

Chapter 3 highlighted the persistently high levels of agricultural protection in the OECD.[11] Yet agriculture is crucial to developing countries. It represents almost 40 per cent of their GDP, 35 per cent of exports, and 70 per cent of employment.

Because agriculture is such an important part of both national economic development and daily livelihoods in developing countries, agricultural reform must proceed carefully. Agricultural liberalization presents developing countries with the benefits of increased market access, but also the (potential) costs of higher prices for domestic consumers. The fundamental point is that consumers benefit from lower prices that result from large agricultural subsidies, and producers lose.[12] The producers are typically poor farmers, often far worse off than the urban net consumers. Given the limited capacity of

[11] Total OECD spending on agricultural subsidies is more than US$300bn per year. This is almost six times the total aid from OECD countries to all developing countries (US$50–60bn per year).

[12] There is another reason to be wary of an *excessive* focus on agriculture. Development requires less developing countries to move into sectors with higher rates of potential productivity improvements, to develop their *dynamic* comparative advantage, not just their static comparative advantage.

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developing countries to effect redistributions, there can be a significant welfare loss from such adverse distributional impacts. The net effect of wide-ranging agricultural reform varies across developing countries depending on the composition of their exports and imports of different commodities, and the price sensitivity of those commodities to liberalization. The potential for losses highlights the need for a more fine-grained approach which would differentiate among crops and countries, and emphasizes the importance of adjustment assistance, which would need to vary among developing countries, depending on the magnitude of the adverse impact.[13]

The WTO should focus on liberalizing those commodities which have the largest positive effect on producers and the smallest adverse consumption effects. One determinant of the net effect of this kind of reform is the level of protection for each commodity and the consequent impact of liberalization on prices.[14] Another important determinant of the welfare effects of liberalization is the agricultural trade balance across countries. There is a division between temperate products (some types of crops and livestock), where developing countries are largely net importers and developed countries are largely net exporters, and tropical products, for which developing countries are largely net exporters. Most developing countries are net importers of program crops,[15] which are precisely the commodities that have the highest domestic support and stand to experience the largest price increases. It is therefore not surprising that most studies predict that most developing countries are worse off as a

[13] In addition, countries which are importers of subsidized commodities as well as producers should be allowed to impose countervailing duties. Such duties would simultaneously enable producers to receive prices that would correspond more closely to what they would have received in the absence of the distortionary subsidies in the advanced industrial countries and provide the revenues with which these countries could protect consumers from the adverse consequences of the price increase. Moreover, since those in the advanced industrial countries would receive less benefit from their distortionary subsidies, such a reform might reduce political pressures for the subsidies.

[14] There are large differences in the extent to which different agricultural crops are subsidized. Tariffs are particularly high in the feed grains, dairy, and food grains sectors, while dairy products, meat, and livestock are the world's most subsidized exports. Producer payments are highest for grains and oilseed sectors and lowest for meat, livestock, and dairy (Hertel *et al*. 2000).

[15] This includes Mexico, 'Rest of South America' (a regional average which excludes Argentina and Brazil), China, Indonesia, South Korea, 'Rest of South Asia' (a regional average which excludes India), Tanzania, Zambia, 'Rest of Sub-Saharan Africa' (a regional average which excludes Tanzania and Zambia), and the average of the Middle East and North African Countries. Brazil, India, Argentina, and Vietnam are net exporters (Dimaranan, Hertel, and Keeney 2003).

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result of the terms-of-trade effects following this kind of reform. Indeed Dimaranan, Hertel, and Keeney (2003) find that gains accrue primarily to developed countries in the Cairns Group as well as the two largest developing country exporters, Argentina and Brazil. These countries are the strongest advocates for the existing agricultural reform agenda. Still, it is possible that, as producer prices increase, some developing countries will switch from being net importers to net exporters.

The existence of net losses for developing countries in some areas of reform should not imply that no reform is required—rather it suggests that a selective and gradual approach is needed and that considerable adjustment assistance may be required. The most important subsidies to eliminate would be those where the consumption benefits of the current subsidies are small relative to the cost to producers. Attention should be focused on the elimination of tariffs and quotas on tropical products, processed foods, and other commodities which developed countries export or for which they have high export elasticities with respect to price. Elimination of cotton subsidies would raise producer prices for cotton, but have a small effect on standards of living in developing countries as a result of the small increase in the price of cloth. Similarly, subsidies for crops which are disproportionately consumed by the wealthy will have the least adverse distributional effects.

Furthermore, the potential adverse effects of agricultural liberalization on large segments of society suggest the importance of a gradual approach, allowing urban workers time to adjust. It would also be desirable for developed countries to give some of the money they previously expended on subsidies to assist the developing countries in the transition.

Appendix 1 reviews the empirical evidence on the effect of agricultural liberalization in OECD countries on various regions of the world. Clearly more research needs to be done to identify the precise effects of liberalization on individual poor countries. The studies surveyed in this Appendix indicate that uniform elimination of all agricultural protection could result in negative terms-of-trade shocks for some of the poorest developing countries and sharp declines in farm incomes in Europe and North America. The latter are in a position to

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bear the costs, especially given the large savings from the elimination of subsidies: the former may not be. A reform agenda must carefully discriminate between liberalization instruments and targets. Such an agenda would have three key components.

First, there should be a significant reduction in border protection in developed countries (particularly the EU), including tariff cuts and the elimination of export subsidies. Tariffs on the goods produced primarily by developing countries as well as those consumed primarily in developed countries should be reduced most rapidly. For example, the elimination of US and EU quotas and tariffs on sugar and tropical products would increase the price received by developing world producers but only have a small effect on consumer prices in developing countries. Similarly, the elimination of cotton subsidies would have only a small effect on consumer prices in developing countries.

Second, domestic production support for price-sensitive necessities that are widely consumed in developing countries should be reduced gradually, with some of the savings in developed country subsidy budgets being directed at ameliorating the adjustment costs of those in the developing world. Many developing countries in North Africa, Sub-Saharan Africa and Latin America (though not Brazil, Argentina, or Mexico) rely on imports of subsidized grains and oilseeds from OECD producers. The empirical evidence reviewed in Appendix 1 suggests that these countries are particularly exposed to agricultural reforms which might increase the price of some commodities.

Third, domestic support should be shifted from market price support to alternative payment systems. Reinstrumentation of protection in OECD countries towards the least trade-distorting instruments (such as land-based payments) is one possible means of compensating OECD farmers while minimizing the impact on developing world consumers. But many of the so-called non-trade-distorting subsidies do in fact lead to increased production, and too much has been made of the distinction between export subsidies and production subsidies. The WTO makes a distinction between explicit export subsidies and other forms of domestic subsidies, yet both types of payment can increase production and exports and

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depress world prices.[16] Since domestic subsidies are treated more permissively in the WTO, several OECD countries have reduced their export subsidies and increased their direct domestic support payments to comply with their WTO commitments. In the US and EU, the annual values of export subsidies for cereals and beef declined by US$4.1 billion between 1990 and 1998–9. In the same period, domestic support in the form of exempt direct payments for those commodities rose by an estimated US$18.9 billion a year in the European Union alone (ABARE 2001). However, the trade effects of various types of domestic subsidies are often understated. While the impact of export support on developing countries per dollar of subsidy is greater than production-based support, the difference is small if the elasticity of demand is small, which is the case for many agricultural commodities. Even non-production-based support ('decoupled' payments primarily in the 'Green Box') have an impact on output and prices. These payments Favor OECD producers by providing them with cheap (or free) credit to use potentially for investment and expansion of production. The distinction between trade-distorting subsidies and non-trade-distorting subsidies is based on a particular economic model, in which capital markets are perfect. Trade-distorting subsidies are then subsidies which change the marginal return to production or which reduce the marginal cost of production. Thus generalized income supports in this view are not production-distorting, nor are payments to keep land fallow. But both of these may, in fact, be production-distorting if, for instance, farmers face credit constraints. Then, in effect, the subsidies provide additional finance which allows farmers to expand production.

Liberalization of industrial goods

While average developed country tariff rates are low, developed countries maintain high barriers to many of the goods exported most

[16] The WTO classifies domestic subsidies according to their distortionary effect on trade: amber (directly trade-distorting); blue (indirectly trade-distorting production payments); green (non-trade-distorting).

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intensively by developing countries. When weighted by import volumes, developing countries face average manufacturing tariffs of 3.4 per cent on their exports to developed countries, more than four times as high as the average rate faced by goods from developed countries, 0.8 per cent (Hertel and Martin 2000).[17]

Moreover, aggregate data hide the existence of tariff peaks (discussed in Chapter 3). OECD tariffs are particularly high for goods of importance to poor countries, such as low-skill manufactures (especially textiles) and processed foods. For example, in 2001, clothes and shoes accounted for only 6.5 per cent of US imports in value terms but they brought in nearly half of the $20 billion of US tariff revenue. More tariff revenue was collected by the US government on the import of shoes than on the import of automobiles, even though the value of shoe imports is around one tenth of the value of automobiles.

Comparisons of nominal tariffs do not fully represent the distortion caused by escalating tariff structures, and do not provide information about the impact of tariffs on the value-added of processed products. Thus nominal tariff levels tell us little about the real trade impact of the tariff escalation, and to look more closely at the trade effect we need to examine the 'effective tariff rate'. The effective tariff rate is a function of the tariffs assessed on the component parts and the final product, the technological process involved, and the relative prices of all inputs into the final product. Analysis of tariff escalation using effective tariff rates demonstrates the effect of the existing tariff structures in many developed countries on the industrial development of poorer countries. By imposing higher tariffs on the output of manufactured goods than on primary products, developed countries are in effect imposing significantly higher trade taxes on manufacturing value added in developing countries. Such tariff 'escalation' serves to discourage the development of, for example, food processing in less developed countries since the *effective* tariff rate on value added in food processing is very high. Such tariff peaks and tariff escalation are manifestly unfair and have a particularly pernicious effect on development by restricting industrial diversification in the poorest countries.

[17] The distortion is even larger if one recognizes that the quantities imported are reduced as a result of the high tariff barriers. (In the measure cited, a prohibitive tariff would have no weight in the measure, since there would be no imports.)

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A second reason why developing countries should be pushing to have industrial tariffs given high priority in the Doha Agenda is that barriers to South–South trade are quite high. The average import-weighted tariff on the exports of manufactured goods from developing countries to developing countries is 12.8 per cent (Hertel and Martin 2000). Anderson *et al*. (2000) estimate that the welfare gains to developing countries derived from the liberalization of trade in manufactures by other developing countries is $US31bn.

Non-tariff barriers

It is not surprising that as tariffs have come down, non-tariff barriers have assumed increasing importance. Trade agreements may do little to alter protectionist sentiment—and the politics of special interests. They do, however, change the form that such protection can take. Just as developed countries have discriminated against developing countries in the structure of their tariffs, so too many of the non-tariff barriers have particularly adverse effects on developing countries.

Developing countries have repeatedly found that as they make inroads into a market in the United States or Europe, they are slapped with dumping duties or face some other form of non-tariff barrier. Though ostensibly the Uruguay Round marked the end of the so-called voluntary export restraint, the United States has talked about reinstating such restraints against China. The effect of these non-tariff barriers is far greater than indicated by the actual duties imposed. The fear that they will be imposed has a chilling effect on development: it increases the risk associated with investing in an export-oriented industry, which is particularly important in economies already facing high interest rates. Often initially high duties are imposed only to be revised down substantially but the initially high duties suffice to drive the exporting firm out of business. Some solution to the problems posed by non-tariff barriers should be high on the agenda of any development round.

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There are four important categories of non-tariff barriers: (1) dumping duties, which are imposed when a country (allegedly) sells products below cost; (2) countervailing duties, which can be imposed when a country subsidizes a commodity; (3) safeguards, which can be imposed temporarily when a county faces a surge of imports; (4) and restrictions to maintain food safety or avoid, say, an infestation of fruit flies. The advanced industrial countries have used all of these at times to restrict imports from developing countries when the latter have achieved a degree of competitiveness which allows them to enter the markets of the developed countries. Many of these measures are described as ensuring 'fair trade', but from the perspective of developing countries, they ensure 'unfair trade'. They are evidence of the hypocrisy of the North. Increasingly, however, developing countries are using such measures against each other and against the advanced industrial countries, and in that sense they represent a hidden threat to a trade liberalization regime.

There has been a large increase in the number of anti-dumping claims. Between 1995 and 2002, 2,063 dumping cases were initiated. The US (279) and the EC (255) were two of the largest initiators. It does not seem sensible that the countries with the largest capacity to absorb shocks and compensate import-competing interests should be the most common users of anti-dumping laws.

The problem is that dumping has been used as a safeguard measure when there is a separate safeguard measure for this purpose. There is a reason for this: safeguard measures provide for only temporary protection, to assist in adjustment, while dumping can provide longer-term protection.

Part of the problem with the schemes is how they have been implemented. Consider, for example, America's use of dumping duties. The accused must respond in a short period of time to a long demand for information (in English), and when the accused is unable to do so, the US government acts on the 'best information available' (BIA), usually the information which has been provided by the American company trying to keep out its rivals. High initial duties are imposed, which regularly get revised downward when better information becomes available. But meanwhile, long-term damage has been done, as American buyers will not purchase the commodity

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given the uncertainty about the level of tariffs they may have to pay.[18] America's provisions for dumping duties (and in some cases countervailing duties) for China and some of the former communist countries have been particularly egregious. In the 'surrogate country methodology' which is used to assess the cost of production (the benchmark against which charges of dumping are assessed) costs of production are compared with those of a 'similar' country. In one instance, the United States used Canada as the country most similar to Poland. Not surprisingly it was found that the costs of production were high, justifying a high dumping duty.

Safeguards are another form of non-tariff barrier. A WTO member may take a 'safeguard' action (i.e. temporarily restrict imports of a product) to protect a specific domestic industry from an increase in imports of any product which is threatening to cause serious injury to the industry. Recent years have seen a dramatic increase in the use of safeguards around the world: the incidence of safeguards has risen from 2 in 1995 to 132 in 2002. The increase is a cause for concern because many of the safeguard measures implemented by WTO members are not consistent with WTO rules. Indeed, all safeguard measures examined by WTO panels and the Appellate Body have so far been found to be inconsistent with those rules.

Safeguard measures have been available under the GATT (Article XIX). However, they were infrequently used. The Agreement on Safeguards clarifies and reinforces Article XIX. It sets forth criteria for the application of safeguard measures: 1. the product is being imported in increased quantities, absolutely or relative to domestic production; 2. the product causes or threatens to cause serious injury to domestic industry; 3. the safeguard measure shall only be applied to the extent necessary to prevent or remedy serious injury and to facilitate adjustment.

The safeguard measure has probably been underused by developing countries and has certainly been overused by the United States. American safeguard legislation, for instance, makes insufficient distinction between industries which are declining *because* of trade

[18] For a more complete description of these abuses, see, for instance, Stiglitz (1997).

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and those which would be in decline even in the absence of trade liberalization.

The US Presidential Proclamation of 5 March 2002 imposed safeguard measures on ten steel product groupings in the form of additional tariffs up to 30 per cent. Almost immediately, several countries, including the EC, Japan, South Korea, China, Switzerland, Norway, New Zealand, and Brazil, engaged WTO dispute settlement procedures against these measures. These countries argued that none of the US measures had been taken as a result of unforeseen developments, as required under the WTO rules. For most products, imports had not increased; for all products but one the US had not properly established the necessary causal link to the alleged serious injury suffered by the US steel industry; the US had exempted imports from Canada, Mexico, Israel, and Jordan from the measures in a manner inconsistent with the WTO rules. The WTO's panel substantially agreed and concluded that each of the US measures was in violation of the WTO rules. President Bush's action in imposing steel tariffs exemplifies the misuse of safeguards.

While the argument for safeguard measures is persuasive, they have been widely abused, especially by the developed countries. If the richest country in the world, the United States, with a strong safety net, relatively high employment level, etc. has to resort to safeguard measures to protect itself against a surge of imports, how much more justified are developing countries in imposing such measures. Indeed, it is hard to conceive of many important liberalization measures against which safeguard protections could not justifiably be invoked by developing countries. This highlights again the need to set clearer standards *at the international level*. For instance, for a safeguard measure to be imposed, not only should the country show that there is injury but that it is substantial, entailing a loss, say, of at least 1 per cent of the jobs in the country, and that the burden on the country's social safety net is such that it would be hard pressed to absorb it. The threshold standard should be lower in developing countries. Such a reform would ensure that the safeguard measures would only be used in cases where trade disturbances imposed significant adjustment burdens.

There are three reforms that would make a great deal of difference. The first is to recognize the principle of *national treatment*: in

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addressing problems of unfair trade, the legal framework should be the same for domestic firms as it is for foreign firms. In the case of dumping, for instance, firms are charged with selling below cost. To an economist, the natural question is, 'Why would a firm ever sell below *marginal cost* (and what is the relevant economic concept)?' The answer is to try to drive out rivals, to establish a monopoly or dominant position in a market that would enable it later on to sell at a high price, well above costs. Thus American anti-trust law, in assessing whether predatory pricing (the equivalent of dumping in a domestic context) has occurred, attempts to assess whether price is below the *relevant* cost, and whether there is evidence that it is likely that the accused will recoup his loses. As a result of this high standard, few cases of predatory pricing have been successfully prosecuted. Subjecting foreign firms to the same standard would ensure that dumping charges were being used to preserve competition, not to reduce the threat of foreign competition. (The double standard is highlighted by the fact that if American firms were subject to the standard used in a dumping case, a large proportion of American firms would be found guilty of dumping.)

The second is to create a new international tribunal as the first 'court'. Today when, for instance, the United States accuses firms of a foreign country of dumping, it acts as prosecutor, judge, and jury. Though the process is governed by a 'rule of law', in the sense that there are well-defined procedures, the process often operates in a highly unfair way. There is a costly and lengthy WTO process which can be, and has been, used to rectify gross abuses, as in the case of the US-imposed steel tariffs. But it would be far better if the original decision was taken out of the hands of the country and put into those of a specialized international tribunal.

The third is that the implementation legislation and practices of countries should be reviewed to ascertain whether these is fair and non-discriminatory, both *de jure* and *de facto*, and are in conformity with widely accepted economic principles. An example already referred to is the use of BIA. Almost all economists agree that the relevant cost concept for judging dumping is *marginal* not average costs, yet legislation in many countries uses average costs. This means that dumping charges are often sustained in cyclical industries, in

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downturns, where marginal costs are considerably below average costs.[19]

The determination of whether subsidies have been provided is another example which has been highly contentious. A Development Round should clarify this, in ways which ensure that governments may undertake industrial policies to promote nascent industries. This is particularly important because the *form* of subsidy in the United States—e.g. research in the defense industry, the benefits of which spill over to civilian uses—is markedly different from that in the developing world. Allowing one, but not the other, creates an uneven playing field. Similarly, the IMF often forces developing countries to have high interest rates, well above the 'market rate'. Lending money at more reasonable rates should not be viewed as a subsidy.

A third example concerns the sale of privatized assets, particularly in the former communist economies. Assume that the original investment was subsidized, but the government privatizes the industry through a competitive auction. Such an auction should extinguish the subsidy: the new investor pays, in effect, fair market value for the asset. In a way one can look at the privatization as a bankruptcy/restructuring proceeding. When a firm goes bankrupt, its assets are sold in an auction. The acquiring firm is not viewed as having received a subsidy. The communist economies can be viewed as a large bankrupt enterprise, the assets of which are now being disposed of. On the other hand, when the government effectively gives away the asset, then the subsidy is clearly not extinguished. (A side-benefit of a rule that distinguishes between the two kinds of privatizations is that it would encourage more honest privatizations.)

[19] Moreover, dumping is sometimes found in competitive industries, in which no rational firm would ever engage in predatory pricing, since there is no way it could establish the monopoly power required for it to recoup the losses it makes when it sells below marginal cost.