CHAPTER 3

My six-year-old son should get a job
Is free trade always the answer?

I have a six-year-old son. His name is Jin-Gyu. He lives off me, yet he is quite capable of making a living. I pay for his lodging, food, education and health care. But millions of children of his age already have jobs. Daniel Defoe, in the 18th century, thought that children could earn a living from the age of four.

Moreover, working might do Jin-Gyu's character a world of good. Right now he lives in an economic bubble with no sense of the value of money. He has zero appreciation of the efforts his mother and I make on his behalf, subsidizing his idle existence and cocooning him from harsh reality. He is over-protected and needs to be exposed to competition, so that he can become a more productive person. Thinking about it, the more competition he is exposed to and the sooner this is done, the better it will be for his future development. It will whip him into a mentality that is ready for hard work. I should make him quit school and get a job. Perhaps I could move to a country where child labour is still tolerated, if not legal, to give him more choice in employment.

I can hear you say I must be mad. Myopic. Cruel. You tell me that I need to protect and nurture the child. If I drive Jin-Gyu into the labour market at the age of six, he may become a savvy shoeshine boy or even a prosperous street hawker, but he will never become a brain surgeon or a nuclear physicist—that

would require at least another dozen years of my protection and investment. You argue that, even from a purely materialistic viewpoint, I would be wiser to invest in my son's education than gloat over the money I save by not sending him to school. After all, if I were right, Oliver Twist would have been better off pick-pocketing for Fagin, rather than being rescued by the misguided Good Samaritan Mr Brownlow, who deprived the boy of his chance to remain competitive in the labour market.

Yet this absurd line of argument is in essence how free-trade economists justify rapid, large-scale trade liberalization in developing countries. They claim that developing country producers need to be exposed to as much competition as possible right now, so that they have the incentive to raise their productivity in order to survive. Protection, by contrast, only creates complacency and sloth. The earlier the exposure, the argument goes, the better it is for economic development.

Incentives, however, are only half the story. The other is capability. Even if Jin-Gyu were to be offered a £2 om reward or, alternatively, threatened with a bullet in his head, he would not be able to rise to the challenge of brain surgery had he quit school at the age of six. Likewise, industries in developing countries will not survive if they are exposed to international competition too early. They need time to improve their capabilities by mastering advanced technologies and building effective organizations. This is the essence of the infant industry argument, first theorized by Alexander Hamilton, first treasury secretary of the US, and used by generations of policy-makers before and after him, as I have just shown in the previous chapter.

Naturally, the protection I provide to Jin-Gyu (as the infant industry argument itself says) should not be used to shelter him from competition forever. Making him work at the age of six is wrong, but so is subsidizing him at the age of 40. Eventually he should go out into the big wide world, get a job and live an independent life. He only needs protection while he is accumulating the capabilities to take on a satisfying and well-paid job.

Of course, as happens with parents bringing up their children, infant industry protection can go wrong. Just as some parents are over-protective, governments can cosset infant industries too much. Some children are unwilling to prepare themselves for adult life, just as infant industry support is wasted on some firms. In the way that some children manipulate their parents into supporting them beyond childhood, there are industries that prolong government protection through clever lobbying. But the existence of dysfunctional families is hardly an argument against parenting itself. Likewise, cases of failures in infant industry protection cannot discredit the strategy *per se.* The examples of bad protectionism merely tell us that the policy needs to be used wisely.

3.1. *Free trade isn't working*

Free trade is good—this is the doctrine at the heart of the neo-liberal orthodoxy. To the neo-liberals, there cannot be a more self-evident proposition than this. Professor Willem Buiter, my distinguished former colleague at Cambridge and a former chief economist of the EBRD (European Bank for Reconstruction and Development), once expressed this succinctly: 'Remember: unilateral trade liberalization is not a "concession" or a "sacrifice" that one should be compensated for. It is an act of enlightened self-interest. Reciprocal trade liberalization enhances the gains but is not necessary for gains to be present. The economics is all there'.[1]

Belief in the virtue of free trade is so central to the neo-liberal orthodoxy that it is effectively what defines a neo-liberal economist. You may question (if not totally reject) any other element of the neo-liberal agenda—open capital markets, strong patents or even privatisation—and still stay in the neo-liberal church. However, once you object to free trade, you are effectively inviting ex-communication.

Based on such convictions, the Bad Samaritans have done their utmost to push developing countries into free trade—or, at least, much freer trade. During

the past quarter of a century, most developing countries have liberalized trade to a huge degree. They were first pushed by the IMF and the World Bank in the aftermath of the Third World debt crisis of 1982. There was a further decisive impetus towards trade liberalization following the launch of the WTO in 1995. During the last decade or so, bilateral and regional free trade agreements (FTAs) have also proliferated. Unfortunately, during this period, developing countries have not done well at all, despite (or because of, in my view) massive trade liberalization, as I showed in chapter 1.

The story of Mexico—poster boy of the free-trade camp – is particularly telling. If any developing country can succeed with free trade, it should be Mexico. It borders on the largest market in the world (the US) and has had a free trade agreement with it since 1995 (the North American Free Trade Agreement or NAFTA). It also has a large diaspora living in the US, which can provide important informal business links.[2]

Unlike many other poorer developing countries, it has a decent pool of skilled workers, competent managers and relatively developed physical infrastructure (roads, ports and so on).

Free trade economists argue that free trade benefited Mexico by accelerating growth. Indeed, following NAFTA, between 1994 and 2002, Mexico's *per capita* GDP grew at 1.8% per year, a big improvement over the 0.1% rate recorded between 1985 and 1995.[3]

But the decade before NAFTA was also a decade of extensive trade liberalisation for Mexico, following its conversion to neo-liberalism in the mid-1980s. So trade liberalization was also responsible for the 0.1% growth rate.

Wide-ranging trade liberalization in the 1980s and the 1990s wiped out whole swathes of Mexican industry that had been painstakingly built up during the period of import substitution industrialization (ISI). The result was, predictably, a slowdown in economic growth, lost jobs and falls in wages (as better-paying manufacturing jobs disappeared). Its agricultural sector was also hard hit by subsidized US products, especially corn, the staple diet of most Mexicans. On

top of that, NAFTA's positive impact (in terms of increasing exports to the US market) has run out of steam in the last few years. During 2001–2005, Mexico's growth performance has been miserable, with an annual growth rate of *per capita* income at 0.3% (or a paltry 1.7% increase in total over five years).[4]

By contrast, during the 'bad old days' of ISI (1955–82), Mexico's *per capita* income had grown much faster than during the NAFTA period—at an average of 3.1% per year.[5]

Mexico is a particularly striking example of the failure of premature wholesale trade liberalization, but there are other examples.[6]

In Ivory Coast, following tariff cuts of 40% in 1986, the chemical, textile, shoe and automobile industries virtually collapsed. Unemployment soared. In Zimbabwe, following trade liberalization in 1990, the unemployment rate jumped from 10% to 20%. It had been hoped that the capital and labour resources released from the enterprises that went bankrupt due to trade liberalization would be absorbed by new businesses. This simply did not happen on a sufficient scale. It is not surprising that growth evaporated and unemployment soared.

Trade liberalization has created other problems, too. It has increased the pressures on government budgets, as it reduced tariff revenues, this has been a particularly serious problem for the poorer countries. Because they lack tax collection capabilities and because tariffs are the easiest tax to collect, they rely heavily on tariffs (which sometimes account for over 50% of total government revenue).[7]

As a result, the fiscal adjustment that has had to be made following large-scale trade liberalization has been huge in many developing countries—even a recent IMF study shows that, in low-income countries that have limited abilities to collect other taxes, *less than 30%* of the revenue lost due to trade liberalization over the last 25 years has been made up by other taxes.[8]

Moreover, lower levels of business activity and higher unemployment resulting from trade liberalization have also reduced income tax revenue. When countries were already under considerable pressure from the IMF to reduce

their budget deficits, falling revenue meant severe cuts in spending, often eating into vital areas like education, health and physical infrastructure, damaging long-term growth.

It is perfectly possible that *some* degree of *gradual* trade liberalization may have been beneficial, and even necessary, for certain developing countries in the 1980s—India and China come to mind. But what has happened during the past quarter of a century has been a rapid, unplanned and blanket trade liberalization. Just to remind the reader, during the 'bad old days' of protectionist import substitution industrialization (ISI), developing countries used to grow, on average, at double the rate that they are doing today under free trade. Free trade simply isn't working for developing countries.

3.2. *Poor theory, poor results*

Free trade economists find all this quite mysterious. How can countries do badly when they are using such theoretically well-proven ('the economics is all there', as Professor Buiter says) policy as free trade? But they should not be surprised. For their theory has some serious limitations.

Modern free trade argument is based on the so-called Heckscher-Ohlin-Samuelson theory (or the HOS *theory*).* The HOS theory derives from David Ricardo's theory, which I outlined in chapter 2, but it differs from Ricardo's theory in one crucial respect. It assumes that comparative advantage arises from

*The HOS theory is named after the two Swedish economists, Eli Heckscher and Bertil Ohlin, who pioneered it in the early 20th century, and Paul Saumelson, the American economist who perfected it in the mid-20th century. In this version of free trade theory, for each product there is only one 'best practice' (i.e., most efficient) technology, which all countries will use if they are producing it. If each product has one best production technology for its production, a country's comparative advantage can *not* be determined by its technologies, as in Ricardo's theory. It is determined by how suitable the technology used for each product is for the country. In the HOS theory, the suitability of a particular technology for a country depends on how intensively it uses the factor of production (i.e., labour or capital) with which the country is relatively abundantly endowed.

international differences in the relative endowments of 'factors of production' (capital and labour), rather than international differences in technology, as in Ricardian theory.[9]

According to free trade theory, be it Ricardian or the HOS version, every country has a comparative advantage in some products, as it is, by definition, *relatively* better at producing some things than *others*. In the HOS theory, a country has comparative advantage in products that more intensively use the factor of production with which it is relatively more richly endowed. So even if Germany, a country relatively richer in capital than labour, can produce *both* automobiles *and* stuffed toys more cheaply than Guatemala, it pays for it to specialize in automobiles, as their production uses capital more intensively. Guatemala, even if it is less efficient in producing both automobiles and stuffed toys than Germany, should still specialize in stuffed toys, whose production uses more labour than capital.

So, 'comparative' in the term 'comparative advantage' is not about comparison between countries but about comparison between products. It is because people mix these two up that they sometimes believe that poor countries do not have comparative advantage in anything—which is a logical impossibility.

The more closely a country conforms to its underlying pattern of comparative advantage, the more it can consume. This is possible due to the increase in its own production (of the goods for which it has comparative advantage), and, more importantly, due to increased trading with other countries that specialize in different products. How can the country achieve this? By leaving things as they are. When they are free to choose, firms will rationally (like Robinson Crusoe) specialize in things that they are relatively good at and trade with foreigners. From this follows the propositions that free trade is best and that trade liberalization, even when it is unilateral, is beneficial.

But the conclusion of the HOS theory critically depends on the assumption that productive resources can move freely across economic activities. This assumption means that capital and labour released from any one activity can im-

mediately and without cost be absorbed by other activities. With this assumption—known as the assumption of 'perfect factor mobility' among economists—adjustments to changing trade patterns pose no problem. If a steel mill shuts down due to an increase in imports because, say, the government reduces tariffs, the resources employed in the industry (the workers, the buildings, the blast furnaces) will be employed (at the same or higher levels of productivity and thus higher returns) by another industry that has become relatively more profitable, say, the computer industry. No one loses from the process.

In reality, this is not the case: factors of production cannot take any form as it becomes necessary. They are usually fixed in their physical qualities and there are few 'general use' machines or workers with a 'general skill' that can be used across industries. Blast furnaces from a bankrupt steel mill cannot be remoulded into a machine making computers; steel workers do not have the right skills for the computer industry. Unless they are retrained, the steel workers will remain unemployed. At best, they will end up working in low-skill jobs, where their existing skills are totally wasted. This point is poignantly made by the British hit comedy film of 1997, *The Full Monty*, where six unemployed steel workers from Sheffield struggle to rebuild their lives as male strippers. There are clearly winners and losers involved in changing trade patterns, whether it is due to trade liberalization or to the rise of new, more productive foreign producers.

Most free trade economists would accept that there are winners and losers from trade liberalization but argue that their existence cannot be an argument against trade liberalization. Trade liberalization brings overall gains. As the winners gain more than what is lost by the losers, the winners can make up all the latter's losses and still have something left for themselves. This is known as the 'compensation principle'—if the winners from an economic change can fully compensate the losers and still have something left, the change is worth making.

The first problem with this line of argument is that trade liberalization does *not* necessarily bring overall gain. Even if there are winners from the process, their gains may not be as large as the losses suffered by the losers—for example,

when trade liberalization reduces the growth rate or even make the economy shrink, as has happened in many developing countries in the past two decades.

Moreover, even if the winners gain more than the losers lose, the compensation is not automatically made through the workings of the market, which means that some people will be worse off than before. Trade liberalization will benefit everyone only when the displaced workers can get better (or at least equally good) jobs quickly, and when the discharged machines can be re-shaped into new machines—which is rarely.

This is a more serious problem in developing countries, where the compensation mechanism is weak, if not non-existent. In developed countries, the welfare state works as a mechanism to partially compensate the losers from the trade adjustment process through unemployment benefits, guarantees of health care and education, and even guarantees of a minimum income. In some countries, such as Sweden and other Scandinavian countries, there are also highly effective retraining schemes for unemployed workers so that they can be equipped with new skills. In most developing countries, however, the welfare state is very weak and sometimes virtually non-existent. As a result, the victims of trade adjustment in these countries do not get even partially compensated for the sacrifice that they have made for the rest of society.

As a result, the gains from trade liberalization in poor countries are likely to be more unevenly distributed than in rich countries. Especially when considering that many people in developing countries are already very poor and close to the subsistence level, large-scale trade liberalization carried out in a short period of time will mean that some people have their livelihoods wrecked. In developed countries, unemployment due to trade adjustment may not be a matter of life and death, but in developing countries it often is. This is why we need to be more cautious with trade liberalization in poorer economies.

The short-run trade adjustment problem arising from the immobility of economic resources and the weakness of compensating mechanisms is, although serious, only a secondary problem with free trade theory. The more serious

problem—at least for an economist like myself—is that the theory is about efficiency in the short-run use of given resources, and *not* about increasing available resources through economic development in the long run; contrary to what their proponents would have us believe, free trade theory does *not* tell us that free trade is good for *economic development.*

The problem is this—producers in developing countries entering new industries need a period of (partial) insulation from international competition (through protection, subsidies and other measures) before they can build up their capabilities to compete with superior foreign producers. Of course, when the infant producers 'grow up' and are able to compete with the more advanced producers, the insulation should go. But this has to be done gradually. If they are exposed to too much international competition too soon, they are bound to disappear. That is the essence of the infant industry argument that I set out at the beginning of the chapter with a little help from my son, Jin-Gyu.

In recommending free trade to developing countries, the Bad Samaritans point out that all the rich countries have free(ish) trade. This is, however, like people advising the parents of a six-year-old boy to make him get a job, arguing that successful adults don't live off their parents and, therefore, that being independent must be the reason for their successes. They do not realize that those adults are independent *because* they are successful, and not the other way around. In fact, most successful people are those who have been well supported, financially and emotionally, by their parents when they were children. Likewise, as I discussed in chapter 2, the rich countries liberalized their trade only when their producers were ready, and usually only gradually even then. In other words, historically, trade liberalization has been the *outcome* rather than the *cause* of economic development.

Free trade may often—although not always—be the best trade policy *in the short run*, as it is likely to maximize a country's current consumption. But it is definitely not the best way to develop an economy. In the long run, free trade is a policy that is likely to condemn developing countries to specialize in sectors

that offer low productivity growth and thus low growth in living standards. This is why so few countries have succeeded with free trade, while most successful countries have used infant industry protection to one degree or another. Low income that results from lack of economic development severely restricts the freedom that the poor countries have in deciding their future. Paradoxically, therefore, 'free' trade policy reduces the 'freedom' of the developing countries that practise it.

3.3. *The international trading system and its discontents*

Never mind that free trade works neither in practice nor in theory. Despite its abysmal record, the Bad Samaritan rich countries have strongly promoted trade liberalization in developing since the 1980s.

As I discussed in the earlier chapters, the rich countries had been quite willing to let poor countries use more protection and subsidies until the late 1970s. However, this began to change in the 1980s. The change was most palpable in the US, whose enlightened approach to international trade with economically lesser nations rapidly gave way to a system similar to 19 th-century British 'free trade imperialism'. This new direction was clearly expressed by the then US president Ronald Reagan in 1986, as the Uruguay Round of GATT talks was starting, when he called for 'new and more liberal agreements with our trading partners—agreement under which they would fully open their markets and treat American products as they treat their own'.[10]

Such agreement was realized through the Uruguay Round of GATT trade talks, which started in the Uruguayan city of Punta del Este in 1986 and was concluded in the Moroccan city of Marrakech in 1994. The result was the WTO regime—a new international trade regime that was much more biased against the developing countries than the GATT regime.

On the surface, the WTO simply created a 'level playing field' among its member countries, requiring that everyone plays by the same rule—how can we argue

against that? Critical to the process was the adoption of the principle of a 'single undertaking', which meant that all members had to sign up to all agreements. In the GATT regime, countries could pick and choose the agreements that they signed up to and many developing countries could stay out of agreements that they did not want—for example, the agreement restricting the use of subsidies. With the single undertaking, all members had to abide by the same rules. All of them had to reduce their tariffs. They were made to give up import quotas, export subsidies (allowed only for the poorest countries) and most domestic subsidies. But, when we look at the detail, we realize that the field is not level at all.

To begin with, even though the rich countries have low average protection, they tend to disproportionately protect products that poor countries export, especially garments and textiles. This means that, when exporting to a rich country market, poor countries face higher tariffs than other rich countries. An Oxfam report points out that 'The overall import tax rate for the USA is 1.6 per cent. That rate rises steeply for a large number of developing countries: average import taxes range from around four per cent for India and Peru, to seven per cent for Nicaragua, and as much as 14–15 per cent for Bangladesh, Cambodia and Nepal.'[11]

As a result, in 2002, India paid more tariffs to the US government than Britain did, despite the fact that the size of its economy was less than one-third that of the UK. Even more strikingly, in the same year, Bangladesh paid almost as much in tariffs to the US government as France, despite the fact that the size of its economy was only 3% that of France.[12]

There are also structural reasons that make what looks like 'levelling the playing field' actually favour developed countries. Tariffs are the best example. The Uruguay Round resulted in all countries, except for the poorest ones, reducing tariffs quite a lot in proportional terms. But the developing countries ended up reducing their tariffs a lot more in absolute terms, for the simple reason that they started with higher tariffs. For example, before the WTO agreement, India had an

average tariff rate of 71%. It was cut to 32%. The US average tariff rate fell from 7% to 3%. Both are similar in proportional terms (each representing around a 55% cut), but the absolute impact is very different. In the Indian case, an imported good that formerly cost $171 would now cost only $132 -a significant fall in what the consumer pays (about 23%) that would dramatically alter consumer behaviour. In the American case, the price the consumer pays would have fallen from $107 to $103—a price difference that most consumers will hardly notice (less than 4%). In other words, the impact of tariff cuts of the same proportion is disproportionately larger for the country whose initial tariff rate is higher.

In addition, there were areas where 'levelling the playing field' meant a one-sided benefit to rich countries. The most important example is the TRIPS (Trade-related Intellectual Property Rights) agreement, which strengthened the protection of patents and other intellectual property rights (more on this in chapter 6). Unlike trade in goods and services, where everyone has something to sell, this is an area where developed countries are almost always sellers and developing countries buyers. Therefore, increasing the protection for intellectual property rights means that the cost is mainly borne by the developing nations. The same problem applies to the TRIMS (Trade-related Investment Measures) agreement, which restricts the WTO member countries' ability to regulate foreign investors (more on this in chapter 4). Once again, most poor countries only receive, and do not make, foreign investment. So, while their ability to regulate foreign companies is reduced, they do not get 'compensated' by any reduction in the regulations that their national firms operating abroad are subject to, as they simply do not have such firms.

Many of the exceptions to the rules were created in areas where the developed countries needed them. For example, while most domestic subsidies are banned, subsidies are allowed in relation to agriculture, basic (as opposed to commercial) R&D (research and development), and reduction of regional disparities. These are all subsidies that happen to be extensively used by the rich countries. The rich nations give out an estimated $100 billion worth of agricultural subsidies

every year; these include the $4 billion given to 25,000 American peanut farmers and EU subsidies that allow Finland to produce sugar (from beets).[13] All rich country governments, especially the US government, heavily subsidize basic R&D, which then increases their competitiveness in related industries. Moreover, this is not a subsidy that developing nations can use, even if they are allowed to—they simply do not do much basic R&D, so there is little for them to subsidize. As for regional subsides, which have been extensively used by the European Union, this is another case of apparent neutrality really serving the interests mainly of rich countries. In the name of redressing regional imbalances, they have subsidized firms to induce them to locate in 'depressed' regions. Within the nation, this maybe contributing to a reduction in regional inequality. But, when viewed from an international perspective, there is little difference between these subsidies and subsidies given to promote particular industries.

Against these accusations of 'levelling the playing field' only where it suits them, the rich countries often argue that they still give the developing countries 'special and differential treatment' (SDT). But special and differential treatment is now a pale shadow of what it used to be under the GATT regime. While some exceptions are made for the developing countries, especially the poorest ones ('the least developed countries' in WTO jargon), many of these exceptions were in the form of a slightly longer 'transition period' (five to ten years) before they reach the same final goal as the rich countries, rather than the offer of permanent asymmetrical arrangements.[14]

So, in the name of 'levelling the playing field', the Bad Samaritan rich nations have created a new international trading system that is rigged in their favour. They are preventing the poorer countries from using the tools of trade and industrial policies that they had themselves so effectively used in the past in order to promote their own economic development—not just tariffs and subsidies, but also regulation of foreign investment and 'violation' of foreign intellectual property rights, as I will show in subsequent chapters.

3.4. *Industry for agriculture?*

Not satisfied with the result of the Uruguay Round, the rich countries have been pushing for further liberalization by developing economies. There has been a push to tighten restrictions on controls over foreign investment, over and above what was accepted in the TRIMS agreement. This was attempted first through the OECD (in 1998) and then through the WTO (in 2003).[15] The move was thwarted both times, so the developed countries have shifted their focus and are now concentrating on a proposal to drastically reduce industrial tariffs in the developing countries.

This proposal, dubbed NAMA (non-agricultural market access), was first launched in the Doha ministerial meeting of the WTO in 2001. It got a critical impetus when, in December 2002, the US government dramatically upped the ante by calling for the abolition of all industrial tariffs by 2015. There are various proposals floating around, but, if the rich countries have their way in the NAMA negotiations, the tariff ceiling for developing economies could fall from the current 10–70% to 5–10%—a level that has not been seen since the days of the 'unequal treaties' in the 19th and early 20th centuries, when the weaker countries were deprived of tariff autonomy and forced to set a low, uniform tariff rate, typically 3–5%.

In return for developing countries cutting industrial tariffs, the rich countries promise that they will lower their agricultural tariffs and subsidies, so that the poor countries can increase their exports. This was sold as a win-win deal, even though unilateral trade liberalization should be its own reward, according to free trade theory.

The proposal was debated in the December 2005 Hong Kong ministerial meeting of the WTO. As no agreement could be reached, the negotiation was extended until the following summer, where it was finally put into a state of suspended animation—Mr Kamal Nath, the Indian commerce minister, famously described the negotiation to be 'between intensive care and crematorium'. The rich countries said that the developing countries were not offering sufficient in-

dustrial tariff cuts, while the developing countries argued that the rich countries were demanding excessively steep industrial tariff cuts and not offering enough reduction in agricultural tariffs and subsidies. The negotiation is stalled for the moment, but this industry-agriculture swap' is basically seen as the way forward by many people, even including some traditional critics of the WTO.

In the short run, greater opening of agricultural markets in the rich countries may benefit developing countries—but only a few of them. Many developing countries are in fact net agricultural importers and thus unlikely to benefit from it. They may even get hurt, if they happen to be importers of those agricultural products that are heavily subsidized by the rich countries. Eliminating those subsidies would increase these developing countries' import bills.

Overall, the main beneficiaries of the opening up of agricultural markets in the rich world will be those rich countries with strong agriculture—the US, Canada, Australia and New Zealand.[16]

Developed countries do not protect many agricultural products exported by poor countries (e.g., coffee, tea, cocoa) for the simple reason that they do not have any domestic producer to protect. So, where protection and subsidies are going to come down is mainly in 'temperate zone' agricultural products like wheat, beef and dairy. Only two developing countries, Brazil and Argentina, are major exporters of these products. Moreover, some (although obviously not all) of the prospective 'losers' from agricultural trade liberalization within rich countries will be the least well-off people by their national standards (e.g., hard-pressed farmers in Norway, Japan or Switzerland), while some of the beneficiaries in developing countries are already rich even by international standards (e.g., agricultural capitalists in Brazil or Argentina). In this sense, the popular image that agricultural liberalization in rich countries is helping poor peasant farmers in developing countries is misleading.*

*The other main beneficiaries of agricultural liberalization in rich countries, that is, their consumers, do not gain very much. As a proportion of income, their spending on agricultural products is already pretty low (around 13% for food and 4% for alcohol and tobacco, of which

More importantly, those who see agricultural liberalization in the rich countries as an important way to help poor countries develop often fail to pay enough attention to the fact that it does not come for free. In return, the poor countries will have to make concessions. The problem is that these concessions—reducing industrial tariffs, dismantling foreign investment controls and abandoning 'permissive' intellectual property rights—will make their economic development more difficult in the long run. These are policy tools that are crucial for economic development, as I document throughout this book.

Given this, the current debate surrounding the liberalization of agriculture in rich countries is getting its priorities wrong. It may be valuable for some developing countries to get access to agricultural markets in developed economies.* But it is far more important that we allow developing countries to use protection, subsidies and regulation of foreign investment adequately in order to develop their own economies, rather than giving them bigger agricultural markets overseas. Especially if agricultural liberalization by the rich countries can only be 'bought' by the developing countries giving up their use of the tools of infant industry promotion, the price is not worth paying. Developing countries should not be forced to sell their future for small immediate gains.

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only a fraction is the cost of the agricultural produce itself). Moreover, the trade in many agricultural products they buy is already liberalized (e.g., coffee, tea, cocoa).

*In the earlier stages of development, most people live on agriculture, so developing agriculture is crucial in reducing poverty. Higher agricultural productivity also creates a pool of healthy and productive workers that can be used later for industrial development. In the early stages of development, agricultural products are also likely to account for a high share of exports, as the country may have little else to sell. Given the importance of export earnings for economic development that I discussed earlier, agricultural exports should be increased as much as possible (although the scope may not be large). And, for this, greater opening of agricultural markets in the rich countries is helpful. But increased agricultural productivity and agricultural exports often require state intervention along the line of 'infant industry promotion'. Agricultural producers, especially the smaller ones, need government investment and support in infrastructure (especially irrigation for production and roads for exports), international marketing and R&D.

3.5. *More trade, fewer ideologies*

It is hard to believe today, but North Korea used to be richer than South Korea. It was the part of Korea that Japan had developed industrially when it ruled the country from 1910 until 1945. The Japanese colonial rulers saw the northern part of Korea as the ideal base from which to launch their imperialist plan to take over China. It is close to China, and has considerable mineral resources, especially coal. Even after the Japanese left, their industrial legacy enabled North Korea to maintain its economic lead over South Korea well into the 1960s.

Today, South Korea is one of the world's industrial powerhouses, while North Korea languishes in poverty. Much of this is thanks to the fact that South Korea aggressively traded with the outside world and actively absorbed foreign technologies while North Korea pursued its doctrine of self-sufficiency. Through trade, South Korea learned about the existence of better technologies and earned the foreign currency that it needed in order to buy them. In its own way, North Korea has managed some technological feats. For example, it has figured out a way to mass-produce Vinalon, a synthetic fibre made out of—of all things—limestone, invented by a Korean scientist in 1939. Despite being the second-ever man-made fibre after Nylon, Vinalon did not catch on elsewhere because it did not make a comfortable fabric, but it has allowed North Koreans to be self-sufficient in clothes. But there is a limit to what a single developing country can invent on its own without continuous importation of advanced technologies. Thus, North Korea is technologically stuck in the past, with 1940s Japanese and 1950s Soviet technologies, while South Korea is one of the most technologically dynamic economies in the world. Do we need any better proof that trade is good for economic development?

In the end, economic development is about acquiring and mastering advanced technologies. In theory, a country can develop such technologies on its own, but such a strategy of technological self-sufficiency quickly hits the wall, as seen in the North Korean case. This is why all successful cases of economic development have involved serious attempts to get hold of and master advanced

foreign technologies (more on this in chapter 6). But in order to be able to import technologies from developed countries, developing nations need foreign currency to pay for them—whether they want to buy directly (e.g., technology licences, technology consultancy services) or indirectly (e.g., better machines). Some of the necessary foreign currency may be provided through gifts from rich countries (foreign aid), but most has to be earned through exports. Without trade, therefore, there will be little technological progress and thus little economic development.

But there is a huge difference between saying that trade is essential for economic development and saying that free trade is best (or, at least, that freer trade is better) for economic development, as the Bad Samaritans do. It is this sleight of hand that free trade economists have so effectively deployed in cowing their opponents—if you are against free trade, they insinuate, you must be against progress.

As South Korea shows, active participation in international trade does not require free trade. Indeed, had South Korea pursued free trade and not promoted infant industries, it would not have become a major trading nation. It would still be exporting raw materials (e.g., tungsten ore, fish, seaweed) or low-technology, low-price products (e.g., textiles, garments, wigs made with human hair) that used to be its main export items in the 1960s. To go back to the imagery of chapter 1, had they followed free trade policy from the 1960s, Koreans might still be fighting over who owns which tuft of hair, so to speak. The secret of its success lay in a judicious mix of protection and open trade, with the areas of protection constantly changing as new infant industries were developed and old infant industries became internationally competitive. In a way, this is not much of a 'secret'. As I have shown in the earlier chapters, this is how almost all of today's rich countries became rich and this is at the root of almost all recent success stories in the developing world. Protection does not guarantee development, but development without it is very difficult.

Therefore, if they are genuinely to help developing countries develop through

trade, wealthy countries need to accept asymmetric protectionism, as they used to between the 1950s and the 1970s. They should acknowledge that they need to have much lower protection for themselves than the developing countries have. The global trading system should support the developmental efforts of developing countries by allowing them to use more freely the tools of infant industry promotion—such as tariff protection, subsidies and foreign investment regulation. At the moment, the system allows protection and subsidies much more readily in areas where the developed countries need them. But it should be the other way around—protection and subsidies should be easier to use where the developing countries need them more.

Here, it is particularly important to get our perspective right about agricultural liberalization in the rich countries. Lowering agricultural protection in those countries may help some developing countries, especially Brazil and Argentina, but not most. Above all, agricultural liberalization in the rich world should not be conditional upon further restrictions on the use of the tools of infant industry promotion by developing nations, as is currently being demanded by the rich countries.

The importance of international trade for economic development cannot be overemphasized. But free trade is *not* the best path to economic development. Trade helps economic development only when the country employs a mixture of protection and open trade, constantly adjusting it according to its changing needs and capabilities. Trade is simply too important for economic development to be left to free trade economists.