

THESIS

The Poverty of Protectionism

Submitted By

Marcus Schultz-Bergin

Department of Philosophy

In partial fulfillment of the requirements

For the Degree of Master of Arts

Colorado State University

Fort Collins, CO

Spring 2011

Master's Committee:

Advisor: Bernard Rollin

Andre Archie
Harvey Cutler

Copyright by Marcus Schultz-Bergin 2011

All Rights Reserved

ABSTRACT

THE POVERTY OF PROTECTIONISM

Much of the modern debate on the global economy takes the form of two ships passing in the dark. The economics literature on the subject defends liberalized trade on empirical grounds while the philosophical literature defends protectionism on theoretical grounds. I aim to unite the literature, arguing against protectionism and defending liberalized trade both empirically and theoretically in the name of poverty reduction.

In chapter 1 I explore two country-specific case studies to get an idea of how trade liberalization benefitted their development and poverty reduction efforts. I also establish a general background for both the economic theory, between protectionism and trade liberalization, as well as the current state of poverty and protectionism in the world.

Chapter 2 seeks to expand the case study analysis to analyze three general ways protectionism and trade liberalization interact with poverty reduction efforts. I argue that trade liberalization, as opposed to protectionism, promotes short term gains to national wealth. Additionally, trade liberalization, as opposed to protectionism, promotes sustained growth and poverty reduction. Finally, I argue that trade liberalization contributes to good governance, while protectionism works against it.

In the final chapter I will consider a theory of fairness for the global economic system and its implications on three aspects of the global economic order: worker exploitation, protectionism in the developed world and the Fair Trade movement.

TABLE OF CONTENTS

ABSTRACT.....	ii
INTRODUCTION	1
CHAPTER 1: A TALE OF TWO STATES	3
1. The Liberalization of Chile’s Economy	3
2. The Shift from Economic Communism to Economic Liberalism in Vietnam.....	8
3. General Remarks on Trade Protectionism and Liberalization	12
3.1. Protectionism Defined	12
3.2. Trade Liberalization Defined.....	16
3.3. Measurements of Trade.....	20
4. The Current State of Poverty and Protectionism.....	23
4.1. Measurements of Poverty	24
4.2. Measurements of Protectionism.....	26
CHAPTER 2: PROTECTING POVERTY.....	33
1. Protectionism and National Wealth.....	34
1.1. The Protectionist’s Story.....	35

1.2. Import Quotas and National Wealth	41
1.3. Tariffs, Subsidies and Wealth Redistribution	45
1.4. Free Trade, National Wealth and Poverty Reduction	49
2. Protectionism and Sustained Growth	62
2.1. The Protectionist's Story.....	62
2.2. Protectionism and Competition.....	70
2.3. Protectionism and Intermediate Goods	74
2.4. Protectionism and Export Performance	76
2.5. Free Trade, Sustained Growth and Poverty Reduction.....	80
3. Protectionism and Bad Governance	89
3.1. The Protectionist's Story.....	90
3.2. Protectionism and Corruption	96
3.3. Protectionism and Conflict	100
3.4. Free Trade, Bad Governance and Poverty Reduction.....	104
4. Conclusion.....	111
CHAPTER 3: GLOBAL ECONOMIC FAIRNESS.....	113
1. Theory of Fairness in the Global Economy	113
1.1. Diachronic and Subjunctive Harm.....	114
3.2. Internal and External Principles.....	120
1.3. Global Economic Fairness as Structural Equity	124

2. Worker Exploitation.....	132
3. Protectionism in the Developed World.....	138
4. Fair Trade.....	145
5. Conclusion.....	151

INTRODUCTION

In 1776 Adam Smith published *The Wealth of Nations*, a systematic moral defense of a market based economy free from government intervention. Since his time, economics and philosophy have mostly parted ways, resulting in a clear distinction between how most philosophers and economists view the global economic order. Economists emphasize the empirical benefits of liberalized trade while philosophers emphasize the theoretical pitfalls of an unfair system. Following from this distinction is a disagreement about how best to organize the global economic system to alleviate or eradicate poverty.

Economists aim to defend liberalized trade as the best development policy for poverty reduction while philosophers tend to promote protectionism or other non-liberal economic models as the most fair development policy for poverty reduction. I will argue, *contra* economists, that fairness and other theoretical issues do apply to economic analysis and, *contra* philosophers, that liberalized trade is the best way to meet both the theoretical and empirical demands of poverty reduction. Put more specifically, I will argue that trade liberalization better contributes to economic growth and poverty reduction than trade protectionism, even though neither is sufficient for economic growth and poverty reduction all on its own.

In chapter 1, I will make use of two country-specific case studies to illustrate how developing countries have empirically employed liberal economics to fight poverty as

well as provide the framework necessary to understand trade protectionism, trade liberalization and poverty. Chapter 2 will make use of this framework to argue that trade protectionism fails and trade liberalization succeeds in reducing poverty at three levels: in the short term through national wealth, in the long term through sustained growth and by contributing to the effectiveness of government. Chapter 3 will conclude with a concerted defense of a particular theory of fairness as it applies to the global economic order, particularly in terms of worker exploitation, protectionism in the developed world and the Fair Trade movement.

CHAPTER 1: A TALE OF TWO STATES

Since the end of World War Two, there has been resurgence in global economic integration. This process unites countries under a common system aimed at mutual gain. To understand this system requires both empirical and theoretical insight. Neither form of insight offer a conclusive view on the relationship of trade to poverty reduction. In order to produce a more insightful conclusion it will be necessary to employ both theoretical and empirical analysis. In this chapter I will first offer two empirical case studies of the successes of trade liberalization. Section one explores the liberalization of Chile's economy that started in the 1970s. Section two looks at the more recent case of Vietnam's liberalization starting in the late 1980s. After exploring those two case studies I will then offer a general framework for understanding trade protectionism and liberalization in section three. Section four will conclude the chapter with an explanation of the current state of protectionism and poverty in the developing world.

1. The Liberalization of Chile's Economy

For many in the anti-globalization movement, Latin America is a poster region of the debacles associated with free trade. Indeed, as economists cite the successes of Asian nations such as Taiwan and Hong Kong, the dissenters cite an entire region that was seemingly left behind in the wake of the worldwide push for liberalized trade. But such a totalizing view neglects the incredible success of Chile, the only economy to make a concerted effort at trade liberalization. Indeed, as Brazil and Argentina, two of the most

oft-cited examples of free trade failing to pull people out of poverty, were wavering between a declared policy of import substitution and a need to import some goods, Chile was lowering all barriers to trade, embracing the global market, and succeeding all along the way. Even more amazing, when a financial crisis struck the region in the late 1990s Chile, while certainly not immune to the effects, continued its pursuit of global market integration and came out of the financial crisis as strong as ever, while its larger neighbors Argentina and Brazil suffered. Chile was not special in the world, or even in the region, but Chile succeeded through sheer political will and proper planning. By exploring its journey a blueprint of what other impoverished nations can do to improve their economies and, most importantly, their citizen's livelihoods may arise.

Chile was much like any other Latin American country in the early 1970s. It had very high tariffs, poorly run government and an impoverished population. This all began to change between 1975 and 1979, when Chile eliminated all quantitative restrictions and exchange controls and reduced import tariffs from over 100 percent to a uniform 10 percent.¹ While this is certainly not complete free trade, what is important is the massive lowering of barriers. Certainly, a tariff-free economy is still preferential but when tariffs are hovering over 100 percent of the product cost a reduction to only 10 percent is rightly considered a move in the right direction.

The initial results seem to support the view of the anti-free trade movement that opening of trade collapses domestic economies, as firms that were previously protected

¹ Douglas A. Irwin, *Free Trade Under Fire* (Princeton, N.J.: Princeton University Press, 2009), 188. Also see Sebastian Edwards and Daniel Lederman, "The Political Economy of Unilateral Trade Liberalization: The Case of Chile," in Jagdish Bhagwati (ed.), *Going Alone: The Case for Relaxed Reciprocity in Freeing Trade* (Cambridge: MIT Press, 2002).

from global competition began to close their doors, unable to compete. However, the reason some firms had to close their doors wasn't because free trade *made* them uncompetitive, but because they simply *were* uncompetitive, but due to market manipulation through the imposition of tariffs on competing products this uncompetitiveness wasn't made manifest. The removal of the barriers led to legitimate competition and certainly some firms suffered. But alongside the closing of a few inefficient firms there was a massive boom in the efficiency of firms that did stay open. Sectors of industry that now had to compete grew their efficiency by 3 to 10 percent more than sectors of industry not facing external competition. Additionally, the initial productivity difference between the firms that closed their doors and those that stayed open was 8 percent, again indicating that the market manipulation had propped up inefficient industries that never had any hope of succeeding on the global market.²

Across the economy the benefits of an open market were felt to a much greater extent than the harms associated with the closing of inefficient industries. Beginning in the 1980s, only a year after the end of the 4-year reform period, Chile saw across the board growth. Imports and Exports both moved from roughly 15 percent of GDP in 1970 to 30 percent of GDP in 1998, and whereas Chile was previously heavily dependent for its exports on the unstable metals market, it was able to diversify its exports to establish more sustained growth. Specifically, Chile went from metal exports being 64 percent of its total exports in 1980 to just 46 percent in 1996.³ This diversification is a critical component of successful economic policy. Were Chile to remain so dependent for its

² Nina Pavenik, "Trade Liberalization, Exit, and Productivity Improvements: Evidence from Chilean Plants," *Review of Economic Studies* 69 (January 2002): 245-276.

³ *Ibid.*, 83-84. The data on metal exports can be found in footnote 28 on page 84.

trade income on metals, a shock to the market, something that is always possible especially in the resource market could have easily had devastating effects on the economy as a whole. By diversifying Chile was able to shelter itself from possible price shocks and also put itself in a position for more long-term, sustained growth. Just as your investment advisor encourages diversification in your stock portfolio so that blows to one sector of the market don't result in the loss of your entire retirement savings, Chile's diversification put its economy in a stable position for long term success.

As evidence of this preparation paying off, Chile is the only major Latin American country that has registered sustained rapid growth throughout the 1980s and 1990s. Between 1981 and 1991 it grew at an annual rate of 5.3 percent and it grew at the greater rate of 5.9 percent annually between 1991 and 2001. This parallels a rapid growth in exports of goods and services, at 8.6 percent for the first period and 9 percent for the second. Finally, its imports to gross domestic product (GDP) ratio also greatly increased in this period, from 26.8 percent in 1991 to 32.7 percent in 2001.⁴

Certainly, however, this was not accomplished merely by liberalizing trade. While trade was certainly a necessary component of reforms, Chile, unlike its Latin American neighbors, benefitted from well managed macroeconomic affairs on behalf of its government. The government reduced its spending and taxes and focused on creating an environment conducive to growth, the result of which was a reduction in inflation from 21 percent in 1989 to a mere 3 percent in 1999, which includes the beginning of the Latin

⁴ Arvind Panagariya, "Miracles and Debacles: Do Free-trade skeptics have a Case?" *World Economy* 27, 1149-72. 1179-80.

American financial crisis.⁵ To put this in context, the inflation rate in the United States in 1999 was 2.2 percent and increased to 3.4 percent the following year.⁶ Chile's monetary policies, then, appear to put it on par with the United States, at least in terms of a key measurable in the economy.

The above case study has indicated how Chile's policies of trade liberalization helped it outpace its neighbors in nearly every economic measure over two and a half decades. But economic growth is meaningless unless it is tied to real gains for the individuals in the country, and especially those living in poverty. And Chile did indeed not only see real gains to its economy, but succeeded in translating those gains into tangible benefits for its people. Between 1990 and 1998 the percentage of Chile's population living below the poverty line moved from 38.6 percent to 21.7 percent. Those living below the extreme poverty line, the lower half of the poverty line, also moved from 12.9 to 5.6 percent. Additionally, this same period saw real wages increase at 4 percent annually; this means people were getting paid more for doing the same job. And finally, spending on education and healthcare rose by nearly 150 percent and more than 120 percent, respectively.⁷ This increase in healthcare and education spending indicates that not only are the private benefits of economic growth, such as job availability and wage increases, reaching the people but the increase in government tax revenue is actually being reinvested in ways that benefit the population in the short- and long-term. Indeed, the most recent Global Competitiveness Report released by the World Economic Forum

⁵ Ibid., 1180.

⁶ US Inflation Calculator, "New Inflation Rates with Chart, Graph and Table," August 3, 2008 (<http://www.usinflationcalculator.com/site-information/new-inflation-rates-with-chart-graph-and-table/1000137/> accessed 03/19/2011)

⁷ Arvind Panagariya, "Miracles and Debacles: Do Free-trade skeptics have a case?" 1199.

has Chile ranked as the 30th most competitive nation for 2010, the most competitive nation in Latin America, and its nearest regional competitor is Brazil at 56.⁸

There is certainly still more to be done in Chile, to pull the remaining population out of poverty, but the government has put itself in a position to achieve that goal. In fact, current president Sebastián Piñera just recently pledged to end poverty in the country within the next decade and the nation's economy came close to President Piñera's growth goal of 6 percent this year.⁹ Chile, then, is a beacon of the successes of free trade and its comparison to its neighbors, namely Brazil and Argentina, during the same time period indicate why the only thing protectionism really protects in the end is poverty's hold on a population.

2. The Shift from Economic Communism to Economic Liberalism in Vietnam

Chile's growth began during a period of successes for a lot of other nations as well, and all the benefits of its reforms are still accruing. But Vietnam, still nominally a Communist Dictatorship, represents a more recent case study of the benefits of liberalized trade. Chile's closest regional neighbor on the Global Competitiveness Report, Brazil, ranks at 56. Nipping at Brazil's heels, however, is the nation of Vietnam, currently ranked 59th.¹⁰ What is even more amazing about this ranking is that Vietnam succeeded in reaching it in effectively only two decades, whereas Brazil has been trying

⁸ Klaus Schwab, "The Global Competitiveness Report 2010-2011," *World Economic Forum* (September 9, 2010), 126-127.

⁹ Martin Sandbu and John Paul Rathbone, "Pledge to End Poverty in Chile," *The Financial Times* (October 19, 2010). Also see Boletín Mensual, "Cuentas Nacionales de Chile: Evolución de la actividad económica en el año 2010," *Banco Central de Chile* (March 2011, http://www.bcentral.cl/estadisticas-economicas/publicaciones-estadisticas/trimestrales/pdf/CuentasNacionales_cuarto_trimestre2010.pdf, accessed March 19, 2011)

¹⁰ Klaus Schwab, "The Global Competitiveness Report 2010-2011," 346-347.

to grow using at least somewhat liberal economic policies for a much greater period of time. Vietnam's shift from one of the poorest nations in the world, dominated by Marxist economics, to one of the fastest growing market-based economies all began in the late 1980s, as a series of reforms known as *Doi Moi* began to be instituted.

The *Doi Moi* reforms began in the agricultural sector, where the majority of the poor found their living. Specifically, the agricultural sector accounted for about 40 percent of GDP and 70 percent of total employment in the late 1980s. The reforms included many different, complementary policies including dismantling collective farms and liberalizing foreign trade and investment.¹¹ Since these policies were initiated in the late 1980s, the expected results should be found in the 1990s and indeed they are. During the 1990s GDP growth averaged 7.9 percent per year, much higher than the regional average of 5.5 percent in East Asia and the Pacific (excluding China) and 5.6 percent in South Asia. This growth did not fail to reach the agricultural sector either, as growth in that sector averaged 4.8 percent per year, higher again than the 3.1 percent average in the East Asia and Pacific region.¹² This growth hasn't stopped either, as recent predictions place Vietnam's growth rate for 2010 at 6.7 percent of GDP, above even the Communist Party's predictions for that year.¹³ While this growth, starting in the early 1990s, is an incredible feat in itself it is much more impressive because of its positive impact on poverty reduction within a nation where nearly the entire population was living in absolute poverty in the late 1980s.

¹¹ Arsenio M. Balisacan, et. al., "Economic Growth and Poverty Reduction in Viet Nam," *Asian Development Bank Economic Research Department Working Paper*, no. 42 (June 2003), 1.

¹² *Ibid.*

¹³ "Vietnam Sees Promising 2010 GDP Growth," *Business Spectator*, October 15, 2010.

In 1988 75 percent of the Vietnamese population was living in absolute poverty. Due to the trade liberalization and complementary policies of *Doi Moi*, however, by 1993 this number had already fallen to 58 percent and continued to fall at a rate of 4.1 percentage points per year all the way down to 29 percent by 2002.¹⁴ This was aided by the easing of export quota policies, whereby the government would restrict the amount of a good that could leave the country. Specifically, the government opened up its rice market to a greater amount of exports, thereby improving the condition of the rural poor, who were among of the poorest in the country. Additionally, Vietnam opened itself up to be a major exporter of labor-intensive goods, often the first place a developing country starts as it opens itself to the world market. Labor-intensive goods are especially beneficial to the poorest people of a nation because they require very little skill to create but pay appreciably better than most alternatives available at the time, such as agricultural work.¹⁵ Such an opening to new labor-intensive industries also led to an increase in foreign-owned companies setting up production in Vietnam. These oft-titled “sweatshops” were incredibly important to the Vietnamese people pulling themselves out of poverty. In 1998 37 percent of Vietnamese workers were classified as impoverished, but only 8 percent of Vietnamese workers working for foreign-owned businesses met this classification. Additionally, no workers in foreign-owned businesses in Vietnam were below the absolute poverty line.¹⁶

¹⁴ Irwin, *Free Trade Under Fire*, 188-89. Balisacan, et. al., “Economic Growth and Poverty Reduction in Viet Nam,” 1-2.

¹⁵ David Dollar and Borje Ljunggren, “Vietnam,” in Padma Desai (ed.), *Going Global: Transition from Plan to Market in the World Economy* (Cambridge: MIT Press, 1997).

¹⁶ Irwin, *Free Trade Under Fire*, 209.

All of this indicates that well designed policies of economic liberalization can lead to the sort of growth that truly does benefit the impoverished, and it does so not just by raising income levels but also by improving the conditions by which people are able to improve themselves, such as literacy. Alongside the great reductions in poverty financially, Vietnam saw its literacy rate increase to 92.9 percent, an increase in life expectancy to 69 years old and a reduction in mortality rates to the relatively low level of 37 out of 1,000 births during the late 1990s.¹⁷

The upshot of this examination of Vietnam's experience with economic liberalization is that economic growth does not tend to bypass the poor, but instead tends to help them, sometimes even more than it does the wealthy. Vietnam's poorest 20 percent experienced such an unequal benefit, as household economic data collected by the Vietnamese government and United Nations indicated that Vietnam's growth during the 1990s, and continuing into the twenty-first century, actually had an appreciably larger benefit for the poorest 20 percent of the population than it did for the wealthiest 40 percent of the population. Specifically, these surveys indicated that a 10 percent increase in overall income for the nation was associated with a 7 percent increase in income for the poorest 20 percent of the population.¹⁸ While Vietnam's experience certainly entailed many more reforms than just the liberalization of trade, the ability of a previously closed society to quickly and effectively move to an open economy while greatly reducing poverty provides hope that such economic growth and poverty reduction is not out of reach for any nation-state, no matter their current situation.

¹⁷ Balisacan, et. al., "Economic Growth and Poverty Reduction in Viet Nam," 1-2.

¹⁸ Ibid., 8 and 14.

3. General Remarks on Trade Protectionism and Liberalization

The remarkable growth and poverty reduction in Chile and Vietnam is neither an isolated event nor a miracle. These two countries benefitted not from luck, but from careful application of well-established economic principles that are available to all nation-states. All that is required is a strong political commitment to reform. Indeed, “Cross-country evidence, country case studies and the evidence on global poverty uniformly demonstrate that growth has served the poor better than any other instrument of poverty reduction.”¹⁹ In chapter two I will closely examine both the poverty-related harms of protectionism and the poverty-related benefits of liberalization, but first, here, I will make it clear what constitutes protectionism, liberalization and the mechanisms by which such dynamics are measured.

3.1. Protectionism Defined

Protectionism, at its root, is a political policy whereby the government enacts policies that interfere in the market economy. There are two general types of protectionist policies that are most prevalent in the world. The first is import tariffs, or taxes specifically on goods being imported by the country enacting the policy such that those foreign goods end up costing more than they otherwise would. The second is export subsidies, or government grants to particular industries that are used to artificially reduce the cost of producing a particular good so that it may be sold cheaper on the international market than the market would naturally dictate. While these are the two most common types of protectionist policies they are not the only types, but to get at what protectionism

¹⁹ Arvind Panagariya, “Miracles and Debacles: Do Free-trade skeptics have a Case?” *World Economy* 27, 1149-72. 1153.

really is it is useful to explore the similarities between import tariffs and export subsidies. This can be done by examining the goal of the policies or by examining the result of the policies. Obviously, if these policies were one hundred percent effective then the goal and the result would be equivalent. However, as I will argue later the result is often times not what was desired, and to only explore the goal without the result may also rule out policies that have the result of being protectionist without the intended goal. However, if protectionist policies are problematic it is not because of their goal, but their result and as such the result of such policies will be the key emphasis for determining whether the policy is indeed protectionist in nature. However, because some protectionist policies can simply fail to achieve their aims while still being truly protectionist, the aim of the policy can also be used as a secondary basis for determining its nature as protectionist or not.

The aim, and often the result, of both import tariffs and export subsidies is the same – to protect an industry or industries from true market competition. By imposing tariffs on imported automobiles, for instance, a country is able to shield its domestic automobile industry from competition, allowing it to “compete” with foreign products in the domestic market. By imposing export subsidies on exported automobiles, on the other hand, a country is able to expand the market for its domestically-produced automobiles beyond just the domestic market while minimizing market influence, thus allowing the industry to succeed where it may otherwise fail. Thus, the commonality between both import tariffs and export subsidies is the manipulation of market pricing in the name of protecting an industry, either in the domestic or international market.

From this, a general principle can be derived for use in determining if a policy is protectionist or not: If the policy in question, in its results especially but even just in its

aim, allows an industry or industries to compete, domestically or internationally, when the market would seemingly dictate otherwise, then the policy is protectionist in nature. This principle is much more extensive than what other philosophers concerned with trade have put forth. According to Darrell Moellendorf in determining whether a policy is protectionist or not the focus should be based merely on its effectiveness in shielding the domestic good(s) from competition.²⁰ While this certainly is *a* factor in determining whether the policy is protectionist in nature or not, I am still concerned with failed protectionist policies because even if they fail to achieve their goal of shielding domestic goods from competition they may have other consequences, good or bad, that are of importance. However, examining merely the aims of the policy to determine its nature fails to recognize that there are, perhaps, policies not generally considered protectionist that ought to be viewed in the same light as import tariffs and the like.

The above has provided a general sketch of what counts as protectionism, but it is also important to examine how such policies can be deployed within a larger economic or development scheme in order to get clear the extent of the effect of protectionism on a country, and particularly on poverty within that country. Specifically, import tariffs can be wholly applied, as when any vehicle attempting to enter a country has to pay a set tax; import tariffs can also be applied based on a quota system, whereby a certain number of vehicles can enter the country without paying a tariff, but once that number is reached any remaining vehicles attempting to enter the country within the given time period are subject to a tariff, generally much higher than if all imported automobiles were subject to

²⁰ Darrell Moellendorf, *Cosmopolitan Justice* (Cambridge, MA: Westview Press 2002), 55.

such a tariff. Finally, import tariffs can be imposed in concert with subsidies under the development plan known as import substitution, whereby a country erects restrictive barriers to goods it previously imported while simultaneously supporting the growth of the industries necessary to provide the goods previously imported. Each of these three strategies results in its own problems, which will be explored in detail later, but for now I will further explain how these three methods of protection interact.

When flat-rate tariffs are imposed on goods, they tend to be imposed at levels that still allow the goods to be imported, but due to the increase in cost a less advanced domestic industry is able to remain competitive within the domestic economy. The tariff tends not to be fully restrictive of the import of the good, because the goal often times is to increase government revenue by requiring foreign producers to pay the government a fee for entrance into the market. Quota-based tariffs, on the other hand, are aimed at limiting the amount of a good in the country, generally in hopes of supporting a fledgling domestic industry without totally upsetting previous suppliers. Specifically, the government will set a quota of how many of a particular good can come into the country tariff free, and then sign agreements with particular suppliers to provide particular amounts of that good, up to the total quota. Any supplier attempting to enter the market with that good either without an agreement with the government or after the quota has been met then faces a tariff that is generally high enough to make such goods completely uncompetitive, thereby effectively preventing any additional imports. As I will consider more in detail in chapter two, the general consensus among economists is that import quotas are a less efficient economic mechanism than a flat-rate tariff, which in turn is less efficient than no protection at all.

Either flat-rate tariffs or import quotas can be used as the tariff complement of a strategy of import substitution. Generally, however, a strategy of import substitution includes very high tariffs, similar to those imposed on goods over the quota, at a flat rate. Thus, whereas regular flat-rate tariffs still tend to allow a good in, but at a higher price, and import quotas freely allow a certain amount of a good in, tariffs imposed under a scheme of import substitution seek to completely eliminate the import of the good. Such a policy necessarily requires government support for the growth of a domestic industry to replace the industries locked out by the high tariffs. It is this method of tariff implementation which is most often supported by those philosophers and heterodox economists concerned with third world development. Indeed, imposition of tariffs in the name of import substitution has been a popular development strategy in the past and continues to be supported as a best-fit strategy for certain nation-states.

I have now indicated a general definition of protectionism as well as examined the three main ways the most common protectionist policy, import tariffs, can be applied. While it would be quite simple to merely indicate that trade liberalization is just the removal of these barriers, that would not be the whole story. As the successes of Vietnam and Chile indicate, trade liberalization must necessarily include complimentary policies if it is to have any effect at all. Therefore, I will turn to an explanation of what trade liberalization *actually means* when it is undertaken.

3.2. Trade Liberalization Defined

Certainly at the core of trade liberalization is the removal of import tariffs and export subsidies, alongside any other policies that are protectionist in aim or result. A fully liberalized economy will have no barriers to imports and no manipulation of

exports. All prices of goods coming in and out will be defined in terms of world prices, absent of course the manipulation by other countries. But liberalization is marked by a few additional important details. First, it necessitates a strong rule of law in terms of contracts and private property. Additionally, it requires quality macroeconomic policy, such as control of government spending and no manipulation of the nation's currency or financial markets. Finally, there must be sufficient infrastructure to support trade, such as functional and accessible ports and a good system of domestic freight transport. These three conditions are by no means exhaustive of the sorts of ancillary reforms necessary to fully reap the benefits of liberalized trade, and it may indeed be possible to reap at least some benefits of liberalized trade without such complimentary policies, but history has shown that these three compliments to trade liberalization greatly increase access to the benefits of trade liberalization and may in fact prevent access to any benefits of trade liberalization if not pursued in concert with liberalization policies.

Strong protection of contracts and private property in the law ensure a legal environment conducive to foreign investment and engagement. This is because absent strong protection for contracts, foreign companies have no confidence that deals they sign with distributors or intermediary businesses in the country will be held to or that they will have recourse if violations do occur. Additionally, absent strong protection for private property there is always a fear that others, especially the local government, will expropriate the goods or infrastructure without recompense. Since the goal of trade liberalization is to bring in the lowest-priced, highest-quality goods possible, any policy that threatens to exclude a foreign business that may be able to provide the lowest-priced,

highest-quality good is a policy that threatens to minimize the benefits of trade liberalization.

On top of strong legal protections for contracts and private property, trade liberalization is greatly complimented by good and stable macroeconomic policy. Many of the failures of countries to reap the benefits of trade can be traced back to poor macroeconomic management, such as extremely wasteful government spending or government manipulation of the nation's currency. Wasteful government spending can often result in poor confidence in the future of the nation's economy, resulting in companies reducing their involvement, leaving altogether or never entering the country to begin with. Wasteful government spending often hints at a corrupt or unsustainable government that threatens the rule of law protecting contracts and private property as well as risking policy reversals that threaten a company's interests in that country. Additionally, trade liberalization relies substantially on the variances between currencies to regulate the dynamic processes of imports and exports. More specifically, as a country increases its imports its currency declines in value relative to the country's currency it is importing from. The result of this, in a system without artificially manipulated currency values, is that the country with the lower valued currency is now a lucrative nation to import from. Thus, one of the general principles of liberalized trade, which argues that increases in imports lead to increases in exports, relies upon a currency valued by the market, not by the government.²¹

²¹ Douglas A. Irwin, *Free Trade Under Fire*, 82-84.

A government with strong rule of law and macroeconomic stability puts itself in a position to bring in the lowest-priced, highest-quality goods but unless it meets the third complimentary condition of trade liberalization, it still may not experience all the benefits it otherwise could. Trade openness can lead to higher incomes in economies that are flexible enough to alter based on market dictates as opposed to those heavily regulated by the government, but trade facilitation is also very important to not only a country gaining the benefits of trade, but more critically for the most impoverished to accrue the benefits.²² Trade facilitation includes both government policy and trade supporting infrastructure. For instance, an open economy lacking roads or other necessary types of infrastructure for low transport costs is unlikely to actually accrue the benefits of trade, especially for those individuals in rural areas, who are often the most impoverished. Additionally, trade facilitation requires port efficiency, transparency of government regulations and efficient and transparent inspections and documentation.²³ Absent such regulatory transparency and infrastructure the lowest-priced and highest-quality goods will remain stuck in ports, just out of reach of those people who need them most.

The important conclusion to draw from the above discussion of the complimentary policies necessary to see the full benefits of trade liberalization is that the question that needs to be asked in determining whether to pursue free trade policies should be are such policies more conducive to sustained growth than alternatives, not whether it leads to such growth.²⁴ The answer to such a question, as I will defend in detail later, is that “the developing countries that have most successfully reduced poverty have

²² Ibid., 191.

²³ Ibid., 192-193.

²⁴ Arvind Panagariya, “Miracles and Debacles: Do Free-trade skeptics have a Case?” 1159.

been significantly integrated into the global economy, by carefully and opportunistically relying on global markets, in order to reap the benefits of trade, investment, lending, and aid.”²⁵ Therefore, while I cannot draw the conclusion that trade openness is sufficient for growth and development, and therefore poverty reduction, it is certainly the case, empirically, that there is no growth and development, and therefore poverty reduction, without low and declining barriers to trade.

3.3. Measurements of Trade

If low and declining barriers to trade are a necessary condition for growth, how are such barriers measured and, additionally, how is growth measured to determine if a country is truly growing under low or declining barriers? These measurements can be done with several different methods, so I will quickly sketch some of the most important that will be used throughout. The first, and simplest measure of trade barriers relates to measurement of tariffs on goods. These measurements generally output as the percentage tax, or the quota limit followed by the percentage tax, paid on a wide swath of goods. Thus, the measurements can be broken down into individual goods but are most often found, in discussions of trade openness and protectionism, in terms of separation into industrial goods, agricultural goods and services. Generally speaking, tariffs are highest among agricultural goods and lower among industrial goods and services. Tariffs can also be measured with a uniform number, an aggregate of all tariffs in the country, but often times this can be misleading since a very high tariff may balance out with a very low

²⁵ Aaron James, “How to Defend Sweatshop Labor: Fairness in the Global Economy,” *Work in Progress* (November 2010), 10.

tariff to lead to a report of moderate tariffs, meanwhile some goods are wholly or nearly wholly restricted from access.

Tariff measurements, along with analogue subsidy measurements, can provide a relatively accurate account of the sorts of barriers to trade within a country, but it is also important to understand how to measure the trade that is actually occurring within the country. This is critical because even if a country has a low aggregate measure of tariffs, some tariffs may be so high in key sectors that trade is greatly hampered. Therefore, to measure the *effect* of the trade barriers it is important to measure the imports and exports of the country, along with their trend. This is most often done by measuring the percent of imports to gross domestic product (GDP) and the percent of exports to GDP. Thus, a country that is highly integrated into the world economy should have a high and upward trending percent of both imports and exports to GDP. While the best form of growth may be a large increase in exports to GDP without a complimentary increase in imports to GDP, which would indicate the country is producing and selling more on the world market than it is purchasing, as I sketched above as one of the general principles of trade, imports and exports are not independent of each other, and indeed growth in either one almost always, and rightly, leads to an increase in the other, and vice versa for declines in either. Thus, it is generally preferable for growth in both imports and exports to GDP with the trend that exports grow a little more than imports down the line. But initially a massive increase in imports to GDP is to be expected and not necessarily harmful, as a country begins to import all the intermediary goods it needs to make its export sectors stronger.

On top of measuring barriers to trade and the trade itself, to understand if the country, as a whole, is actually benefitting from such trade there must be measurements of a country's economy generally. These measurements can be done in a few different ways: with a measurement of GDP, which is an estimated measure of the total value of a country's production and services over one year; Gross National Product (GNP), which is a measure of how the nationals of the country are doing economically and is defined as the GDP plus total capital gains from overseas investment minus income earned by foreign nationals domestically. More generally, GNP measures how much of the money entering a country is actually staying in the country, or otherwise benefitting citizens of that country, whereas GDP will simply measure an economy's performance, regardless of whether that money stays in the country or not. Generally, these two measurements will be seen in terms of percent growth, not as a solid number. While it is certainly important to know where a country sits in terms of its GDP and GNP, to understand if open trade is benefitting the country or not the best mechanism is the change over time, thus producing the percent growth within that country.

Both GDP and GNP can additionally be broken down into per capita terms, indicating how much each individual within the country possesses of the overall GDP or GNP. This is an important measure because it takes into account the fact that a massively high GDP means nothing if the population is also massively high, and additionally that even marginal gains in a country with smaller population may be of great benefit. Per Capita GDP is simply a measurement of the GDP split evening among the population, while Per Capita Income is a measurement of the GNP split evening among the population. It is important to note here that these measurements are necessarily flawed in

that they divide the GDP or GNP evenly across the population, even though it is clear that not all people will share in the wealth equally. Again, then, it is important to look at percent growth in per capita income or per capita GDP to see if an economy is actually growing, more so than perhaps just looking at static numbers.

The upshot of the above discussion is that there are multiple measures of economic success and trade openness, all of which were important in fully understanding the successes of Chile and Vietnam above and which will all be important in fully understanding whether protectionism or trade liberalization better benefit a developing country, and in particular its impoverished population. With a general understanding of protectionism, liberalization and measurements of both it is now possible to turn to the current state of protectionism and poverty in the world, namely among lesser developed nations.

4. The Current State of Poverty and Protectionism

I have already sketched above how I intend to measure the current state of protectionism among countries, but it will also be important to measure the current state of poverty, which requires an understanding of how to measure poverty, which again is something that can be done in multiple ways. I will sketch below a general understanding of poverty measurements as well as provide some numbers on global poverty. I will then move to a discussion of protectionism while applying the measures of poverty more generally to particular countries or regions to highlight the link between protectionism and poverty.

4.1. *Measurements of Poverty*

Multiple institutions, including the United Nations and the World Bank, produce “poverty lines” that separate people based on particular income levels. In general these lines are a helpful guide in understanding the number of people impoverished in the world, but these lines may not fully indicate the extent of the problem. According to the World Bank, in 2004 2.5 billion people, or roughly 40 percent of the global population were living in “severe poverty”.²⁶ This is a measure of consumption expenditure per person per year and indicates that these individuals have a purchasing power less than what \$785.76 had in the United States in 1993. Additionally, 950 million of this 2.5 billion live on less than half of that number, which puts them at or below the World Bank’s “extreme-poverty line”.²⁷

While these numbers are certainly staggering, what is more staggering is that this doesn’t explain the entire problem. The real harm of poverty comes in its removal and continual deprivation of the basic goods necessary to even minimal subsistence. According to the United Nations 830 million individuals are chronically undernourished, 1.1 billion lack access to safe water, 2.6 billion lack access to basic sanitation and 1 billion lack adequate shelter.²⁸ Unless increasing purchasing power actually solves these issues, then decreasing the number of people living in severe poverty won’t really mean much. Additionally, unless there is a decrease in the number of people who die each day

²⁶ Thomas Pogge, *World Poverty and Human Rights* (Malden, MA: Polity Press 2008): 2.

²⁷ *Ibid.*, 2-3.

²⁸ The first three figures are from UNDP, *Report 2006*, pp. 174 and 33. The figure on shelter is from UNICEF, *Report 2005*, p. 22.

from poverty-related causes, which accounts for a full third of all human deaths at 50,000 each day, then we cannot truly say we have done anything to combat global poverty.²⁹

Based on this data, I will be working with two main indicators for determining poverty – the first will be an aggregative indicator, such as the World Bank’s severe poverty line. Additionally, I will examine actual increases and decreases in indicators of subsistence – nourishment, clean water and shelter. While the aggregative indicators do not tell the whole story, in general they will be useful analogues for understanding overall poverty, but in situations where it becomes necessary to explore systematic or institutional-level denial of subsistence particular measurements may be more enlightening. From here on out, any mention of a poverty line, unless otherwise indicated, will reflect the World Bank’s severe poverty line listed above. Additionally, any mention of an extreme poverty line will reflect the World Bank’s extreme poverty line (which is half of the severe poverty line).

The trend of poverty over recent decades has been overall underwhelming, with a few key success stories. China, India, Chile and Vietnam all represent legitimate success stories of poverty reduction. However, due to increases in global population, the absolute number of people living in poverty has failed to decline to any great extent. Studies conducted by the World Bank conclude that while there has been a decrease in the proportion of people living below the poverty line, the decline is minimal enough that based on population growth there has been very little change in the absolute number of people living in poverty. Specifically, the study found that the proportion of people living

²⁹ World Health Organization, *Report 2004*, pp. 120-5 and UNICEF, *The State of the World’s Children 2005*, inside front cover.

in poverty declined from 28.3 percent in 1987 to 23.2 percent in 1999, which results in a reduction of the absolute number from 1.18 billion to 1.17 billion across the same time period.³⁰ While for the 10 million individuals that have pulled themselves out of poverty recent trends cannot be considered a failure, the key issue here is that more could be done to further reductions, both in proportional and absolute numbers. What is evident in breakdowns of the global poor, however, is that it is those nations that have opened themselves up economically that have had the greatest success in reducing both the proportion and absolute number of people living in poverty within their borders.³¹ With that in mind, I will turn now to current measures of protectionism in the world, especially among the developing countries. By examining the current state of protectionism and poverty in the developing world it will become clearer that economic liberalization is indeed a vital component of poverty reduction.

4.2. Measurements of Protectionism

Many opponents of globalization in general and trade liberalization in particular argue that the notion that economic liberalization helps alleviate poverty has been tried and failed and should therefore be disregarded. And certainly trade liberalization has been promoted as the path to development and poverty reduction for the past few decades, but to argue that such a development policy has been tried and found wanting is to ignore the fact that nearly every country in the world still erects barriers to trade, even if the barriers are more porous than the past. Indeed, the anti-globalization movement, particularly some non-governmental organizations such as Oxfam and cosmopolitan

³⁰ Arvind Panagariya, "Miracles and Debacles: Do Free-trade skeptics have a Case?" 1201.

³¹ *Ibid.*, 1150.

philosophers such as Thomas Pogge, must recognize such facts when they argue “the harsh reality is that [developed country] policies are inflicting enormous suffering on the world’s poor. When rich countries lock poor people out of their markets, they close the door to an escape route from poverty.”³² They clearly admit that trade barriers do exist, at least in the developed world, and that such barriers have a negative influence on poverty reduction. Nonetheless, these same authors and organizations refuse to recognize that the developing world’s protectionism, as bad as it is, is in fact dwarfed by the protectionism in the developed world.

Tariff rates in developing countries, while widely varying, are invariably higher than in most developed countries. For instance, Bangladesh has an average tariff rate for all goods of 14.6%, while the US has an average tariff rate of 2.7% on all goods.³³ While I argued above that merely aggregating all tariffs in a country can obfuscate the actual impact of particular tariffs, an overall comparison of tariffs in the developing and developed world can illuminate the uphill battle being fought by those individuals and groups concerned with development policies that emphasize a liberalized economy. Speaking more generally, the developed world has tariffs, on average, of less than 5 percent while the developing world tariffs vary between 10 and 30 percent, on average.³⁴ These average tariffs take into account both agricultural tariffs and industrial tariffs, but it is almost universally true that protectionism is more prevalent and greater in the agricultural sector than the industrial sector, especially in the developed world.

³² Oxfam, *Rigged Rules and Double Standards: Trade, Globalization, and the Fight Against Poverty* (London: Oxfam, 2002).

³³ Irwin, *Free Trade Under Fire*, 72-73.

³⁴ *Ibid.*, 177.

The above numbers give a very rough idea of the state of protectionism in the world today, but what is of more importance is the trend of protectionism over the past three or four decades, and the link such a trend has to poverty trends. Often those individuals and groups opposing globalization and liberalized trade point out that even if reports indicate a declining trend for poverty globally, such declines are heavily concentrated in China and India. Removing just China from the measurements results in the number of people categorized as extremely poor being unaltered for the past 20 years.³⁵ This first obviously makes use of absolute numbers of people, as opposed to proportions of the population to make its strong claim. But even more problematic with citing such measurements as evidence that liberalized trade fails the poor is that the concentration of poverty reduction in China and India is to be expected considering it is these two developing countries leading the charge of open markets and free trade.

To decide to ignore the fact that many countries that have embraced free trade, such as China, India, Chile, Vietnam, South Korea, Taiwan, Singapore and Hong Kong, in the name of proving a point is to truly miss the point. The reason poverty reduction is so concentrated in a select few developing countries is because it has thus far only been a select few developing countries that have embraced the sorts of policies that promote economic growth, and thus poverty reduction. Specifically, Hong Kong, Singapore, Taiwan and South Korea are the most open and fastest growing economies of East Asia and all have entirely eliminated poverty based on a dollar-a-day criterion.³⁶ Meanwhile, the majority of the developing world has pursued protectionist policies of import

³⁵ Shaohua Chen and Martin Ravallion, "How Have the World's Poorest Fared since the Early 1980s?" *World Bank Research Observer* 19 (2004), 153.

³⁶ Arvind Panagariya, "Miracles and Debacles: Do Free-trade skeptics have a Case?" 1195-6.

substitution, if they have pursued a unified development policy at all. Brazil, for instance, was the flagship of import substitution during the same period that Chile was the flagship of economic liberalization. The results are clear, as they were outlined at the beginning of this chapter: Chile won, Brazil didn't. Brazil is now catching on, and seeing positive results, so the conclusion is still clearly in favor of economic liberalization.

If it is true that economic liberalization is almost always successful, at least when combined with complementary economic and social policies, then at least some explanation must be given for why so few countries have actually pursued such policies. Douglas Irwin attempts one explanation, namely that the benefits of trade protection are highly concentrated, in a particular industry for instance, while the costs are widely diffused. This can at least partially explain the prevalence of protectionism in the world, basically arguing that it is a political problem.³⁷ A government, even if it wants to help its people, receives distorted information about what its people want, and acts on that distorted information. Additionally, the lack of trade reform can be linked to the sort of mindset many national leaders, in developed as well as developing nations, have when their nation is wreaked by crisis. Just as we often do here in America when faced with crisis, national leaders and the general population will often turn inward, especially when the crises can be linked to external circumstances. Developing nations, of course, tend to find themselves in crisis more often and thus such a mindset, latent as it may be in the

³⁷ Douglas Irwin, *Free Trade Under Fire*, 92.

developed world at times, is front and center in the developing world and thus leads to bad policy decisions.³⁸

Additionally, economic theory associated with what sustains an economy is occasionally at odds with development theory that emphasizes what policies are needed to start a country on the process of development. Thus, while economic theory argues that low and declining barriers to trade are a necessary condition of sustained rapid growth, some development theorists argue that high trade barriers are necessary early on to develop industries, which will then freely compete on the global market in the future.³⁹ The result, as is too often the case, is that a set of policies intended to be temporary become permanent fixtures of the government, with too much inertia to be changed except in a time of crisis, precisely when the latent isolationist impulses come out the strongest.

It is indeed these three factors that give us a unified tale of protectionism's rise and its maintenance of control in the developing world. Developing countries adopted protectionist policies because they were told temporary protection was a necessary condition of economic development. Such policies had a concentrated set of benefactors, all of whom wound up with the sort of money and clout to pressure the government to maintain such policies even when they had been proven or made ineffective. Finally, when a government may be given a greater hand to act outside of political influence, such as during a crisis, the requisite mindset did not materialize to see liberalized trade policies

³⁸ Dani Rodrik, "The Rush to Free Trade in the Developing World: Why So Late? Why Now? Will it Last?" *National Bureau of Economic Research Working Paper*, no. 3947 (January 1992), 1-2.

³⁹ *Ibid.*, 5.

as at least part of the answer to the crisis. Even worse, since protectionist policies militate against sustained growth, crises were inevitable, thereby ensuring continued bad economic policy. The result has been heavy trade barriers in most of the developing world, poor complementary policies such as artificial manipulation of currency, and, worst of all, greater poverty than may have existed had such policies never been put in place, or been reduced or eliminated when they become inefficient.

The final and perhaps most telling recent development that makes protectionism even more problematic in the developing world is the recent massive growth in trade between developing countries.⁴⁰ Whereas the anti-Globalization movement may have a plausible claim in promoting protectionism in the developing world to improve competitiveness with the developed world, thereby benefitting the poor at the expense of the (relatively) rich, the current state of affairs indicates that protectionist policies are most likely in those industries that developing countries seek to grow into and that developed countries have all but given up on, such as small household goods. But in erecting barriers in hopes of protecting an infant industry from competition, all a developing country is doing is hoping to benefit its poor at the expense of another developing country's poor. Thus, if the concern is, as it should be, the reduction of poverty, a policy that brings some people out of poverty in one country while subjecting more people to poverty, or people to worse poverty, in another country does not appear to be the best option.

⁴⁰ Adrian Wood, et. al., "Symposium on Infant Industries," *Oxford Development Studies*, 31, no. 1 (2003), 3-20. 7.

The goal of this chapter has been to sketch the general idea of economic protectionism and liberalization as well as outline the current state of protectionism and poverty in the developing world. I used Chile and Vietnam as prime examples of the success a developing country can have reducing poverty through economic liberalization. My goal in the next chapter will be to argue that any developing country can benefit from economic policies similar to Chile's and Vietnam's, and that by protecting industries from foreign competition the only thing developing country's governments are truly protecting is poverty's grip on its populace.

CHAPTER 2: PROTECTING POVERTY

I previously sketched how trade liberalization, as part of an overall economic reform, led to successful poverty reduction in both Chile and Vietnam. I now aim to analyze more deeply the reasons protectionism fails to alleviate poverty and how trade liberalization avoids these problems. My method in this chapter will be to outline three general categories that are important to poverty relief and that are harmed by protectionism. I will argue that protectionism harms national wealth, especially in the short term. Additionally, I will argue that such short term harms cannot be justified based on long term gains because protectionism also makes it difficult for a country to sustain positive growth. Finally, I will analyze the relationship between good governance and trade policy, arguing that protectionism often fosters corruption and bad governance.

While I by no means intend to argue that trade liberalization, by itself, can eradicate global poverty, my explicit goal will be to prove that “no matter how you put it, if we are concerned with improving the world’s worst-off, abolishing barriers to global voluntary exchanges should be our first priority.”⁴¹ Thus, even as I admit that the benefits of free trade can be lost without complimentary reforms, any other good economic reforms are sure to miss the mark absent the removal of barriers to free exchange. The question to be answered is not whether protectionism or liberalization, alone, can create

⁴¹ Fernando R. Tesón, “Trade and Global Justice,” *Public Law and Legal Theory Working Paper*, no. 143 (February 2005). 13.

sustained, fast growth and poverty reduction. Rather, the important question is whether protectionism or liberalization is more *conducive* to sustained, fast growth and poverty reduction. With that limit in mind, I will now turn to the first way in which protectionism militates against growth and poverty reduction, through reducing national wealth.

1. Protectionism and National Wealth

The liberal reward of labour... as it is the effect of increasing wealth, so it is the cause of increasing population. To complain of it, is to lament over the necessary effect and cause of the greatest public prosperity. ... It is in the progressive state, while the society is advancing to the further acquisition... that the condition of the laboring poor, of the great body of the people, seems to be the happiest and the most comfortable. The progressive state is in reality the cheerful and the hearty state to all the different orders of the society.⁴²

It is uncontroversial to claim that a key component of economic growth and poverty reduction is the accumulation of national wealth. National wealth is critical to creating new opportunities for people to lift themselves out of poverty as well as for providing necessary social services for the most vulnerable in society. It is no surprise, then, that the battle between protectionism and trade liberalization is often waged on the ability of one more than the other to increase the national wealth. In fact, protectionism is often perceived to have the upper hand when it comes to national wealth, at least in the short term, as it aims to keep more money within the nation, not allowing it to be collected by foreign companies through the purchase of imported goods. While such a view holds initial plausibility, I will argue that protectionism actually harms national wealth in a few important ways while open trade actually lends itself to gains in national wealth.

⁴² Adam Smith, *The Wealth of Nations* (Hoboken, N.J.: BiblioBytes, 1776), NetLibrary e-book, 42.

1.1. The Protectionist's Story

The national wealth argument in favor of protectionism can take at least two different forms. In this section I will motivate both arguments, one which argues against open trade on the grounds that import purchases reduce national wealth and the other which argues that free trade increases inequality. The first argument directly concludes to a loss of national wealth while the second actually emphasizes the harms of wealth redistribution when it moves from the poorer to the wealthier within a society.

A common rallying cry among anti-Globalization groups is that free trade leads to the weak being dominated, at least economically, by the strong.⁴³ It is argued that through free trade the rich and powerful nations like the United States will begin to impose their economic will on developing countries, forcing them to buy foreign goods and thereby denying the developing country's indigenous industries the ability to grow and become competitive. By opening up a market to foreign companies a developing country, with its lack of technological and knowledge parity, will be forced to become totally reliant on foreign nations for all of its goods thereby dooming the nation to perpetual poverty. Indeed, such fears are not completely unfounded. The experience of Jamaica's dairy industry is telling on this subject. Due to market liberalization initiated in the 1980s, Jamaica's large dairy industry suffered at the hands of cheap imports of American powdered milk. The success of America's invasion with a product that should always be more expensive than its fresh counterpart was successful because of American subsidies

⁴³ Oxfam's position on this is telling: "The harsh reality is that [developed country] politics are inflicting enormous suffering on the world's poor. When rich countries lock poor people out of their markets, they close the door to an escape route from poverty." Oxfam, *Rigged Rules and Double Standards: Trade, Globalisation, and the Fight Against Poverty* (London: Oxfam Press, 2002), 5.

paid to U.S. dairy farmers, and the result was a great reduction in the incomes of those in the Jamaican dairy industry.⁴⁴

But such a situation is rare, and relied on the existence of market manipulations in America to succeed. Nonetheless, Jamaica's experience with trade liberalization gives empirical plausibility to the protectionist claim that liberalization will collapse domestic industries. In fact, no person in favor of trade liberalization could deny that some domestic industries may suffer when a country opens up. The reason such industries suffer, however, is different for the protectionist and the free trader. According to the free trader the industry was inefficient and uncompetitive to begin with, and its ability to stay afloat was *caused* by manipulations of the market. Lifting those barriers didn't *make* those industries fail; it simply let the market carry out its natural process. For the protectionist, however, the story is that due to inequities in technology and know-how a developing country *must* have barriers behind which its domestic industries can grow. Once the growth has occurred the barriers may be dismantled, but in so doing it is leaving behind internationally competitive industries that won't suffer at the hands of more developed nations. Temporary market manipulation, then, is justified on the grounds that it will produce real returns to national wealth that no process of trade liberalization and open competition could.⁴⁵

Additionally, a development policy emphasizing replacing imported goods with domestic goods through protection aims to stop the flow of national wealth out of the

⁴⁴ Michael Witter, "Trade Liberalization: The Jamaican Experience," *United Nations Conference on Trade and Development Trade Analysis Branch Working Paper* (October 2005).

⁴⁵ Robert Hunter Wade, "Reply to John Roberts on Infant Industry Protection," in Adrian Wood, "Infant Industry Symposium," *Oxford Development Studies* 31, no. 1 (2003), 9-10.

country in hopes of eventually leading to positive growth. Such a process, however, requires trade barriers as infant industries in the domestic economy develop to be competitive with the already established foreign firms. The defender of protectionism is again left with arguing that short term manipulation is justified due to its long term effects, but also is able to claim that by forestalling the continued hemorrhaging of national wealth protectionism benefits people in the short term.

On top of foreign trade leading to a real loss of national wealth, the protectionist also claims that certain barriers are important to ensure a more fair distribution of national wealth. According to this argument gains due to liberalizing the economy often accrue only to the already wealthy, leaving the impoverished no better off.⁴⁶ There is indeed some reason to believe this to be the case. In most countries the impoverished, especially those living in extreme poverty, are located away from urban centers in rural areas with poor infrastructure. Thus, many development policies will help people in the urban centers, and may even increase national wealth, but the rural poor are left no better off. While a development policy employing barriers to trade is not necessarily in any better of a position to resolve this issue, the belief is that by promoting particular industries a government will be in a better position than the market economy to pull the rural poor into gainful employment.

For instance, many protectionists lay their defense on the claim that many industries have externalities, or external benefits to society from the development of the industry, which are vital to the development of a country. But since firms in the particular

⁴⁶ Guillermo Perry and Marcelo Olarreaga, "Trade Liberalization, Inequality and Poverty Reduction in Latin America," Paper presented at ABCDE (January 2006).

industry don't necessarily gain anything additional from externalities they may not willfully choose to pursue the necessary endeavors.⁴⁷ Protection, then, functions as a motivating force for firms to pursue initiatives that produce wide ranging benefits for society.

On top of externalities which may not be pursued without government intervention, the protectionist will often point to the low wages of "sweatshop labor" to indicate how free trade simply abuses the poor for the sake of the rich.⁴⁸ Low wage sweatshop labor allows for costs to be cut so that foreign nations can either buy their goods cheaper or foreign firms can earn a greater profit on the goods they are selling. In either situation the benefits do not accrue to the poor worker. Such a situation, it is argued, furthers the gap between the rich and the poor and government intervention is important to limit such a widening gap.

The widening gap can be examined both intra- and inter-nationally. At the intra-national level the view is that as a country liberalizes trade a few elites benefit but the vast majority of people, especially the poor, either receive no benefit or may even become worse off. At the international level the view is that as a country liberalizes trade national wealth is transferred from the newly open, developing economies to the powerful developed economies. At either level the supposed culprit is free trade and the supposed answer is protection.

⁴⁷ Arvind Panagariya, "Evaluating the Case for Export Subsidies," *World Bank Policy Research Working Paper* 2276 (2000), 9.

⁴⁸ Charles Rubinfeld, "Tolerating Sweatshops," *Penn Political Review* (November 9, 2010) <http://pennpoliticalreview.org/2010/11/tolerating-sweatshops/>.

Thomas Pogge offers a somber analysis of current and trending international inequality. His category of “high income” countries accounts for roughly 79 percent of the global aggregate income while only possessing 15.7 percent of the global population. These citizens also enjoy a standard of living about five times higher than the worldwide average per capita annually. Additionally, in the year 2000 a study of international inequality determined that the bottom fifty percent of the global population possessed merely 1.1 percent of the global wealth.⁴⁹ Even worse, Pogge argues, is that the situation is actually trending toward greater inequality, not less. Between 1984 and 2004 the consumption expenditure in the high income countries rose 56.3 percent while the consumption expenditure in the poorest one percent of countries, the poorest of the poor, rose only 9.6 percent. For Pogge, this is indicative of the fact that more could be done to alleviate poverty than is currently being done and that it is critically important to begin redistributing wealth down, not up.⁵⁰

Intra-nationally the concern with distributive justice has been the basis of some of the worst development debacles. Latin America is famous for its principled commitment to fair distributional schemes and has paid the price for such a commitment. The argument in highly protectionist countries such as Argentina is that the market does not care about where the wealth goes, it is concerned solely with creating it. As such, government intervention is important to direct the new found wealth to the places where it is needed most. This insight is important, as it is in fact true that Latin America’s

⁴⁹ J. B. Davies, S. Sandstrom, A. Shorrocks, and E. N. Wolff, *The World Distribution of Household Wealth*, WIDER, December 5, 2006. WWW.wider.unu.edu/research/2006-2007/2006-2007-1/wider-wdhw-launch-5-12-2006/wider-wdhw-report-5-12-2006.pdf (accessed September 15, 2010)

⁵⁰ Thomas Pogge, *World Poverty and Human Rights* (Malden, MA: Polity Press, 2008), 104-106.

liberalization in the late eighties and early nineties was accompanied by an unexpected increase in overall income inequality.⁵¹ However, an important issue arises in this discussion relating to whether inequality is a harm in itself, or only insofar as it may point to other harms. Thomas Pogge appears to believe that economic inequality is a harm in itself, regardless of if all people are doing well. However, John Rawls famously argued in *A Theory of Justice* that inequalities can be justified, so long as the inequalities benefit the worst off in society.⁵² Thus, some inequalities may be justified while others may not be. And of course Robert Nozick stood on the other extreme from Pogge, arguing that economic inequality is not a problem at all, except insofar as it may result from non-voluntary transfers such as theft.⁵³

The Latin American experience with liberalization and increasing inequality, then, cannot be fully understood except in the context of absolute costs and benefits to citizens. If the income gap increased simultaneously with all people's incomes rising, and if the unequal distribution to the rich resulted in industrial development that created additional jobs and greater national wealth, then only Pogge's view on inequality produces a harm. It may in fact be the case that trade liberalization is always likely to lead to a widening income gap, but if it can simultaneously raise all people's real incomes, and truly aid people in escaping poverty, then to fail to adopt such policies seems to be the greatest harm. Additionally, as I will argue in the next two sections, protectionism is by no means immune to losses in national wealth and widening income

⁵¹ Guillermo Perry and Marcelo Olarreaga, "Trade Liberalization, Inequality and Poverty Reduction in Latin America," Paper presented at ABCDE (January 2006).

⁵² John Rawls, *A Theory of Justice* (Cambridge, MA: Harvard University Press, 2005).

⁵³ Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974).

inequality. In such an environment, the practical decision cannot be for the policy with no harms but rather the one that provides the greatest benefits to overcome such harms. Unfortunately for those in favor of erecting barriers to trade, protectionism is not the policy that produces the greatest benefits.

1.2. Import Quotas and National Wealth

Import quotas are a form of protectionism most often associated with a development policy of import substitution. Import substitution emphasizes imposing barriers to imports and simultaneously encouraging the growth of domestic industries that replace the goods previously being imported. The development policy succeeds, then, when its domestic firms completely replace goods that were previously imported.⁵⁴ The main problem with import substitution, of which there are many, lies in the imposition of import quotas. Import quotas set actual limits on the amount of a particular good that can be imported into the country. After the limit has been met, a prohibitively high tariff is imposed on any more of the good coming in, so that even if the domestic industry is unable to compete at the market prices their goods will still be bought. These import quotas harm national wealth in a few key ways.

First, the most direct harm relates to the cost manipulation that coincides with import quotas. To illustrate this harm, imagine that a country, call it Protectoria, imposes a 10,000 unit import quota on widgets, such that any widget imported beyond the ten thousandth will be subject to a three hundred percent tariff. Let's assume that the world market price for a widget is one dollar, and that the firms that have been exporting their

⁵⁴ John Roberts, "What Should We Think About Infant Industry Protection?" in Adrian Wood, "Symposium on Infant Industries," *Oxford Development Studies* 31, no. 1 (2003), 4.

widgets to Protectoria before the import quota were selling their widgets for that one dollar world market price. This is a fair assumption to make, considering that if Protectoria was previously importing widgets without any barriers then all makers of widgets in the world would compete for its market, ensuring the price domestically mapped the price globally.

But now Protectoria has imposed an import quota and has given out the import rights to particular foreign firms. These firms can still technically sell their widgets for one dollar each under the quota, since they experience no barriers at that time, but if they decided to export more widgets to Protectoria beyond their quota, they would have to charge at least four dollars per widget, due to the three hundred percent tariff. This leads to both price manipulation and loss of wealth. First, it means that the domestic firms, who likely must sell their widgets for more than one dollar each just to break even may be competitive with imports subject to the quota. The result is that the consumers of Protectoria, that is all people living in the country, pay more than the world market price for the widgets.

Simply paying more for a good isn't necessarily the problem, however, since transport costs or other circumstances could force prices up in a market context. The problem in this situation, however, is that the market is allowing the people of Protectoria to purchase widgets at the world market price, but their government is not allowing them to do so. Such a price manipulation leads to a real loss in national wealth that is especially harmful to the poor, since the poor spend a greater percent of their income on

goods.⁵⁵ Therefore, while the protectionism may be helping the widget industry exist despite its inefficiencies, it is doing so by effectively taxing the poor. This is very clearly a case of Robin Hood in reverse, as money is taken from the most vulnerable and given to those in a relatively better position (and possibly much better position) simply to ensure the industry they poorly chose to develop, considering it can't compete on its own, survives.

This is more than just a redistribution of wealth, however, but often actually results in a loss of wealth as the domestic industries do not use their excess profits to reinvest in their corporation to raise efficiency. Instead, since the protectionism guarantees them a market, they either spend the money personally or save it, neither of which provide a full investment back into the nation's economy.⁵⁶ Additionally, increasing prices above market dictates results in what economists call deadweight losses. Such losses accrue when consumers are forced to spend roughly the same amount of money on fewer of a good, due to its price increasing, while the increase in price makes production of the good more favorable.⁵⁷ Thus, producers produce more and consumers consume less and money that would be injected into the economy were prices lower either doesn't move into the economy, or does so in a different industry. Either way, the goal of developing a particular domestic industry to improve overall national economic performance is hampered.

⁵⁵ DeNeen L. Brown, "The High Cost of Poverty: Why the Poor Pay More," *The Washington Post* (May 18, 2009).

⁵⁶ Fernando R. Tesón, "Trade and Global Justice," *Public Law and Legal Theory Working Paper* 143 (February 2005), 4-5.

⁵⁷ Douglas Irwin, *Free Trade Under Fire* (Princeton, N.J.: Princeton University Press, 2009), 75.

The second major loss due to import quotas comes about when the foreign firms, who could sell their goods at the market price, decide not to because the competition that had previously required them to price competitively has disappeared. Import quotas are handed out to select firms, already limiting the competition. Additionally, the firms that receive such quotas know they have greater control over the market, since other firms can't move in and undercut them. Furthermore, the firms have an idea of the cost of the widgets after the quotas have been fulfilled, and therefore can justifiably conclude that so long as they sell their widgets for even just a small amount less than the domestic firms' prices people will buy their good. Thus, nearly all impetus for competitive pricing has been removed. The only way this situation doesn't arise is if the government succeeds in handing out import licenses to enough foreign firms that some competition still remains. Even in that situation, however, it is likely that prices will still be higher than the world market price, even if not as high.

The result of this price manipulation is a loss of national wealth to foreign nations. Since these foreign firms are now charging more than the market would dictate, those excess profits are being paid by all citizens of Protectoria to the firm, which is then bringing that money back to its home nation.⁵⁸ Thus, while many of the non-governmental organizations and philosophers in favor of protectionism in the developing world argue for it on the grounds of redistributing wealth from the rich nations to the poor, it is quite the opposite that most often occurs. These losses are enough, by themselves, to oppose at least import quotas in the developing world, but there are even

⁵⁸ Ibid., 77.

more, additional expenditures often not taken into account. For instance, the administrative costs of enforcing import quotas is quite high, as every port of entry has to be well secured and customs agents have to be thorough to ensure no firm is surpassing its quota.⁵⁹

These are not direct national losses, since the money will often stay in the domestic economy, but it is government money that could be better spent in endeavors that actually help the people of the country. Especially considering that much of the government's money comes from taxes on its people, to use that money in a way with absolutely no benefit to the vast majority of the citizens is both economically inefficient and quite evidently unfair. The select few in the protected industry may benefit, but all other citizens of the country actually lose out in comparison to a policy of no trade restrictions.

1.3. Tariffs, Subsidies and Wealth Redistribution

It is a common argument among those individuals concerned with distributive justice that liberal, open economies are the enemy of fair distributions of wealth.⁶⁰ While responses to such a claim could fill volumes, I will focus instead on the ways in which the opposite of open, liberal economies result in poor distributional schemes. Specifically, the imposition of import tariffs and export subsidies results in wealth being redistributed from the most vulnerable in society to the most influential.

⁵⁹ Arvind Panagariya, "Evaluating the Case for Export Subsidies," 6, 11.

⁶⁰ Noam Chomsky, *Profit Over People: Neoliberalism and Global Order* (New York: Seven Stories Press, 1999). Also see: Thomas Pogge, *World Poverty and Human Rights* and Darrell Moellendorf, *Cosmopolitan Justice*.

Import tariffs redistribute wealth from the consumer to the producer in much the same way as import quotas do, by raising prices. Import tariffs, which are taxes imposed on imported goods, aim to make less efficient, more costly domestic industries more competitive by shielding them from market competition and imposing higher domestic prices on the good. So the direct impact is the increase in prices, as the one dollar widget with a thirty percent tariff now costs at least \$1.30, assuming prices aren't further increased due to the administrative cost to firms of complying with such barriers. Similar to import quotas, then, tariffs lead to consumers having to pay artificially more for a good with the difference between the market price and the price they pay being accrued by either the domestic industry or the government. It is accrued by the domestic industry when they buy the domestic good, since the domestic firms will sell their goods at the same price as the foreign firms, but they do not have to pay the tariff to begin with. It is accrued by the government when the foreign good is purchased, since the foreign firm would have paid the government the tax but then passed that cost onto the consumer. Import tariffs are in effect additional consumption taxes. And since the poor are required to spend a greater proportion of their income on necessary goods, such a consumption tax is necessarily regressive, imposed more heavily on the lower income bracket than the higher.

Such a *de facto* consumption tax would not necessarily be a problem if the government used that money to provide for social services or other public services important to the people paying the taxes. Unfortunately, that is rarely what happens. While there are many reasons that a government may choose not to fund social programs with tariff money, the important one I will focus on relates to production and export

subsidies. Subsidies are government payouts to firms or industries to encourage particular actions. Export subsidies, then, are aimed at making it cheaper for a domestic industry to export its good to another country. The idea behind such subsidies is that if a domestic firm is technologically behind its international competition, it will be unable to break into any foreign markets, a necessary requirement for any industry to remain solvent for the long term. Thus, the export subsidies allow the firm to break into the market, compete (artificially) and become more efficient so it can eventually compete without market manipulation. Production subsidies follow a similar story, with the emphasis still being on providing temporary aid while an industry becomes more efficient. In this case, however, the goal isn't necessarily to break out to foreign markets, but just stay afloat in the domestic market. Production subsidies, therefore, have a much lower chance of being beneficial in the long term, since absent export growth economic growth cannot be maintained.

These subsidies, then, are funded by the government, but of course the money has to come from somewhere. This again leads to a scenario of Robin Hood in reverse in one of two ways. Either the government must levy taxes directly on the people to pay for the subsidies, in which case the redistribution is quite clear. The more likely scenario, however, is that the government imposes import tariffs on a particular industry to collect money from foreign suppliers of those goods, and then uses that money to pay out subsidies to the domestic firms in the same industry. This is why it is unlikely that a government will ever use its tariff profits to fund social programs; a complete protectionist development policy requires limiting foreign goods *and* encouraging

domestic production.⁶¹ At first glance this sounds pretty fair, as a poor country could impose a tariff on a rich country's exports to fund its own development. However, as I already argued above, the cost of the tariff is not imposed, in the end, on the foreign firms, but rather on the domestic consumers. Specifically, the tariff increases the cost of importing the good into the country. The foreign firm, to prevent the erosion of their profit margins, will simply increase the price of its good in that particular country equivalent to the tariff and perhaps additional administrative fees due to having to comply with the trade barriers. The result remains the same: a transfer of wealth from the consumer to the government, then from the government to domestic producers.

The result of all that has been said in this section is that no matter how the government goes about imposing barriers, whether they be tariffs or subsidies, the final cost is imposed on the consumer in proportion to the amount of their income they spend on the protected goods and any final goods that require the input of the protected goods. Thus, despite appearing at first to be a fair distributional scheme where foreign firms, generally from wealthier nations, are taxed to fund the development of the poorer domestic economy, the truth of the situation is that such protectionism imposes an excessive burden on the consumers, and especially those living in poverty. Not only does such a burden make the situation worse for those already living in impoverished conditions, but it also directly violates one of the basic commandments of economic

⁶¹ Robert Hunter Wade, "Reply to John Roberts on Infant Industry Protection," 9.

theory, that production only exists to serve the consumer and the consumer's interests should never be subjugated to the interest of the producer.⁶²

1.4. Free Trade, National Wealth and Poverty Reduction

One important initial conclusion to draw from what has been argued above is that concerns about unequal distributions of wealth are not just concerns under free trade regimes. Indeed, the result of an in-depth study of protectionism and income distribution involving both cross-country regression analyses and case studies concluded that protection in fact has a negative effect on income distribution. Specifically, the effect of trade policies on distribution is “quantitatively very significant”; highly protectionist countries (mean effective protection of greater than 30 percent) find the income share of the richest 20 percent of the population being four to five percentage points higher than less protectionist and free trade countries.⁶³

On top of this negative claim, however, it is possible to point to two key ways liberalized trade actually benefits national and individual wealth. In the short term free trade lowers prices on goods, thereby ensuring consumers, meaning every citizen within a country, are able to buy the goods they want and need. This is especially important for those living in poverty, as they spend a greater proportion of their income on goods. Even if this money is leaving the country, the benefits of cheaper and better goods for the impoverished cannot be understated. In the long term free trade also succeeds in allowing

⁶² Adam Smith, *The Wealth of Nations* (Hoboken, N.J.: BiblioBytes, 1776), NetLibrary e-book, 234. Specifically, Smith states: “consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer.”

⁶³ Francois Bourguignon and Christian Morrisson, *External Trade and Income Distribution* (Paris: Development Centre of the Organisation for Economic Co-operation and Development, 1989)

a country's economy to grow faster, and faster growth is very closely linked to greater poverty reduction. So not only does free trade not ask individuals to sacrifice the little they have for future hopes, but it actually delivers future positive results without any great short term costs.

The benefits of free trade for the consumer have already been partially explored above, by analyzing the negative effects for the consumer of protectionist barriers. But now I want to establish a more positive case for the benefits of free trade for national wealth, the consumer and all individuals in a country. This will be accomplished in two steps: first, I will argue for the benefits of free trade to the nation as a whole, generally measured by a country's gross domestic product (GDP); second, I will apply the nationwide benefits to individuals, especially consumers.

Generally speaking, the greatest short term benefits to national wealth come from better resource allocation, resulting in greater efficiency and overall growth. Put simply, when a country is forced to focus on what it can do best, as opposed to simply doing whatever it can, it benefits. It's no different from a human being, who could perhaps attempt to complete all activities necessary for survival herself, but will greatly benefit from specializing in a certain area or areas while relying on others to provide the other necessities.⁶⁴ While it isn't impossible to specialize behind trade barriers, free trade does more to promote beneficial specialization by making it much more destructive to fail to specialize. By vastly expanding the market free trade makes specialization possible in all

⁶⁴ Plato's claim in *The Republic* is instructive here: "I think a city comes to be because none of us is self-sufficient, but we all need many things." From Plato, *The Republic*, trans. G.M.A. Grube (Indianapolis, IN: Hackett Publishing Company, 1992), 369b6-7.

countries, including small relatively isolated countries. Such a global division of labor becomes more refined over time and results in increases in citizen's real incomes alongside lower prices.⁶⁵

While open trade is not a sufficient condition for economic success, it is a necessary one because it allows a country to use its limited productive resources such as land, labor and capital more efficiently, resulting in an increase in national income.⁶⁶ Indeed, liberalizing trade has such a close relationship to improving a country's national wealth that adopting such policies can in fact pull a country out of a long-term economic trap, resulting in strong economic gains. This is precisely what trade liberalization did for Mexico starting in 1985.⁶⁷ The empirical results of trade liberalization on national wealth and GDP growth is telling. A particular study used data from 1950 to 1998 to estimate the response of per capita income, investment and trade share to the date of major trade policy changes within a country. The results indicated that the average growth rate within a country increases by about 1.5 percent after trade liberalization reforms are adopted. This also benefits investment rates, which increase between 1.5 and 2 percent after the reforms.⁶⁸

Turkey also provides a prime example of the benefits of trade liberalization for national wealth. After trade reforms which liberalized the economy during the 1980s

⁶⁵ Douglas Irwin, *Free Trade Under Fire*, 31.

⁶⁶ Arvind Panagariya, "Miracles and Debacles: Do Free-Trade Skeptics Have a Case?" *World Economy* 27, 1149-72: 1150. And Douglas Irwin, *Free Trade Under Fire*, 40.

⁶⁷ Rudiger Dornbusch, "The Case for Trade Liberalization in Developing Countries," *The Journal of Economic Perspectives* 6, no. 1 (Winter 1992): 69-85. 79.

⁶⁸ Romain Wacziarg and Karen H. Welch, "Trade Liberalization and Growth: New Evidence," *World Bank Economic Review* 22 (2008): 187-231.

imports increased from only 2 percent in the late 1970s to 10.4 percent per year. Exports also increased from a 1 percent per year *decline* to an amazing 19.2 percent per year growth. Most telling of all, however, is that these gains resulted in overall GDP growth of about 5 percent per year.⁶⁹ The upshot of this discussion is that no matter the overall development strategy of a nation, it is quite uncontroversial to argue that a necessary part of it must be global market integration, as such a policy certainly has “a significant supporting causal role in the growth of nations.”⁷⁰

National growth is only of secondary concern, however, as it nominally measures gains for real citizens of the nation. Thus, when a country’s GDP grows it means there is *in fact* more money in the country, but that money must be possessed. It may be possessed solely in the hands of a dictator, or it may be equally dispersed among the entire population, but it is always possessed. The important claim, then, is that the sort of GDP growth free trade leads to is beneficial to, at least, the vast majority of citizens within a country. Such a claim is justified considering both the theoretical commitments of free trade and the empirical data. Indeed, standard estimates of the link between trade and people’s income shows that a 1 percent increase in trade share increases per capita income at least 0.8 percent, although more controlled studies indicate up to a 2 percent gain in per capita income per 1 percent increase in a country’s trade share.⁷¹

Such growth in per capita income is only an average and therefore could be misleading if, for instance, a select few individuals had exorbitant increases in their

⁶⁹ Rudiger Dornbusch, “The Case for Trade Liberalization in Developing Countries,” 77.

⁷⁰ Aaron James, “How to Defend Sweatshop Labor: Fairness in the Global Economy,” *Work in Progress* (November 2010). Access <https://webfiles.uci.edu/ajjames/Sweatshops.doc>, 11.

⁷¹ Douglas Irwin, *Free Trade Under Fire*, 51.

incomes while the vast majority of people did not. But since per capita measurements take into account population size, this number is only misleading if such gains for the select few were quite massive, which is unlikely. Instead, free trade is often quite egalitarian in the disbursement of its benefits, especially in terms of empowering people with greater economic liberty. By increasing domestic competition, free trade succeeds in curtailing the power of domestic firms thus limiting the exploitation of consumers through high prices and poor service.⁷² This process benefits citizens in two ways: by increasing their economic freedoms and by leading to real, tangible benefits. The increases to economic freedoms should not be understated, as a growing body of institutional knowledge agrees that open trade and the individual freedom that accompanies it results in much more impressive economic outcomes than when the government intervenes.⁷³

By expanding the variety of goods available in the market, and lowering their prices, free trade promotes individual freedom that in turn leads to greater overall economic growth because it becomes possible to actually study and react to consumer demands. In a highly protected country, with limited choices either from a lack of variety or too high of costs, it is difficult to become a successful producer because demand cannot be accurately measured. Thus, the benefits of lower costs are both short term and long term to the consumers and the producers. Additionally, such benefits to personal liberty result in tangible benefits as the lower prices and greater variety, and the accompanying economic freedom, result in businesses improving quality and

⁷² Ibid., 30.

⁷³ Daniel J. Ikenson, "A Protectionism Fling: Why Tariff Hikes and Other Trade Barriers Will be Short-Lived," *CATO Institute Center for Trade Policy Studies Free Trade Bulletin*, no. 37 (March 12, 2009).

productivity. These improvements necessarily bring along increases in living standards within the country.⁷⁴ Finally, increasing living standards also results in longer life expectancies and lower infant mortality rates, which are measurably better in countries with lower tariffs.⁷⁵ The result of liberalized trade, then, is extraordinarily beneficial to the country. Free trade improves national wealth, individual freedom and results in tangible benefits to the citizen's quality of life.

On top of such direct benefits to national and individual wealth, open economies also empirically grow faster than protected ones. This means that even if protectionism *can* succeed in improving the nation's wealth or increasing individual incomes, it will not be able to do so as quickly as free trade. When the difference between living and dying is an additional dollar a day, as it often may be for those living in extreme poverty, the speed with which benefits reach the people can make all the difference.

The literature base concluding that an open economy will grow faster than a protected one is massive. The literature is also very diverse in methodology, including theoretical arguments, cross-country analyses and particular case studies. No matter the method, however, the conclusion is always the same: economic liberalization is a necessary, but not sufficient, condition for fast, sustained growth. In order to analyze this conclusion I will make use of both the theoretical claims as well as heavily emphasizing the cross-country studies on trade and growth.

⁷⁴ Ibid.

⁷⁵ Douglas Irwin, *Free Trade Under Fire*, 186.

Successful trade liberalization increases the ratios of imports and exports to gross national product on a sustained basis.⁷⁶ The result of this increase is country-wide industrialization. Industrialization is critical to successful development and rapid economic growth because it creates many new skills, rather than just using existing skills. Historically, industrialization drives new institutions and services, which means that the beneficial consequences of trade liberalization grow exponentially as more new industries arise through the use of new technology, knowledge and skills coming from other industries in the country.⁷⁷ So, open economies grow faster because greater opportunities arise and the return on investment can be better predicted because of the high level of economic freedom leading to people and companies breaking into industries that are likely to be successful. Econometric analysis has in fact endorsed this conclusion that market openness and low levels of protection benefit growth. While econometric analysis is difficult in terms of measuring trade, the fact that there is no such alternative econometric analysis in favor of protectionism's benefits for growth, there is good reason to accept the results.⁷⁸

Great deals of studies, using many different methodologies, all conclude in the same way as the econometric analyses. Examining the data on growth rates for around 200 countries from 1961 to 1999 provided by the Global Development Network Growth Database the conclusions are much the same. Virtually all countries that grew rapidly

⁷⁶ Dani Rodrik, "The Rush to Free Trade in the Developing World: Why so Late? Why Now? Will it Last?" *National Bureau of Economic Research Working Paper*, no. 3947 (January 1992). 19.

⁷⁷ Sanjaya Lall, "Roberts on Infant Industry Protection: Another Comment," in Adrian Wood, "Symposium on Infant Industries," *Oxford Development Studies*, 31, no. 1 (2003): 3-20, 15.

⁷⁸ John Roberts, "Infant Industry Protection—A Rejoinder," in Adrian Wood, "Symposium on Infant Industries," *Oxford Development Studies*, 31, no. 1 (2003): 3-20, 18.

according to this data did so alongside rapidly expanding exports and imports, indicating greater openness to the market. Even more telling, the countries that show low or negative growth correspondingly had low or declining exports and imports.⁷⁹ Additionally, comparative studies of countries that liberalized trade with those that did not concluded that liberalizing countries see an increase in GDP per worker of 15-20 percent relative to non-liberalizing countries.⁸⁰ Finally, a similar study to this previous one separated countries into two groups: the “globalizers” and the “non-globalizers”, indicating whether or not they opened up economically since 1980. The globalizers cut import tariffs by twice the margin of the non-globalizers and experienced a 5 percent annual increase in real per capita income, compared with only a 1.4 percent annual increase for the non-globalizers.⁸¹

In light of the extensive literature in favor of trade liberalization, the opposition aims to pick out a few successful countries they feel grew behind protectionist walls. Such countries include those of East Asia as well as China and India. However, the “East Asian Miracle”, as it is sometimes called, is not a successful story of growth and industrialization behind protectionist walls. First, two of the most successful East Asian nations were Hong Kong and Singapore, which were during their growth and continue to be two of the most open economies in the world. Their experiences are telling, because they are small countries lacking in resources. But despite having effectively nothing benefitting them geographically or in terms of other natural endowments, they

⁷⁹ Arvind Panagariya, “Miracles and Debacles: Do Free-Trade Skeptics Have a Case?” 1169-71.

⁸⁰ Douglas Irwin, *Free Trade Under Fire*, 53.

⁸¹ David Dollar and Aart Kraay, “Trade, Growth, and Poverty,” *Economic Journal* 114 (February 2004): F22-F49.

succeeded.⁸² Indeed, their success gives hope that any country, no matter its natural endowments, can grow. Additionally, studies completed for the World Bank by Jagdish Bhagwati and Anne Krueger found that once all incentives and disincentives to exports and imports were taken into account, the domestic relative price of tradables closely tracked the world relative price for other East Asian Countries.⁸³ This means that even if protectionist policies did exist, they were being countered resulting in no actual impact, positive or negative. Of course such a situation indicates that it would have probably been cheaper for these nations to simply not impose barriers, as opposed to imposing and countering them, but the conclusion is still the same: they developed without any effective market manipulation.

So the East Asian success stories don't support the protectionist's tale, but what about China and India? Certainly their initial phases of development began behind protectionist barriers, but their continued success was heavily reliant upon rapid liberalization in subsequent years.⁸⁴ Indeed, neither country even began experiencing marked growth until they began focusing on promoting their export industries. Such promotion required counterbalancing market manipulations to the protectionism already in place, but it eventually led to removal of both the original and counterbalancing manipulations. Indeed, the historical story of protectionism and free trade follows a similar pattern. Many of the least developed nations in the world, when faced with economic crises, responded first by imposing protectionist policies, especially import

⁸² Arvind Panagariya, "Evaluating the Case for Export Subsidies," 21.

⁸³ Jagdish N. Bhagwati, "Export-Promoting Trade Strategy: Issues and Evidence," *The World Bank Research Observer* 3, no. 1 (January 1988): 27-57.

⁸⁴ Arvind Panagariya, "The Protection Racket," *Foreign Policy* (September/October 2005).

quotas. Such reactionary moves failed and those countries that realized the failures, including Turkey, Mexico and Peru, later turned to trade liberalization and found real relief from their crises.⁸⁵ Time and time again the conclusion is the same: trade liberalization leads to superior economic growth. This economic growth, in turn, almost never fails to benefit the poor.

To get an idea of the close link between fast growth and poverty reduction one need look no further than the successes of Hong Kong, Singapore, Taiwan and Korea. These four countries are the most open and fastest growing economies in East Asia and all four have successfully eliminated poverty based on a dollar-a-day criterion.⁸⁶ Their successes are by no means an “East Asian Miracle” but are rather the result of sound economic and social policy. There are at least five main effects trade liberalization has on poverty reduction, two direct and three indirect.

Trade liberalization first has the direct effect of creating real income gains for people living in poverty. Specifically, poor countries typically export labor-intensive goods, which gain their value from the labor that goes into them, rather than the intermediate products, and therefore benefit more than just about any other sector of the economy from liberalization, as it brings cheaper inputs into the country, thereby decreasing costs and making more labor-intensive industries competitive.⁸⁷ Such industries include apparel and textiles, the very industries that helped China pull half a

⁸⁵ Dani Rodrik, “The Rush to Free Trade in the Developing World: Why so Late? Why Now? Will it Last?” 35-36.

⁸⁶ Arvind Panagariya, “Miracles and Debacles: Do Free-Trade Skeptics Have a Case?” 1195-1196.

⁸⁷ *Ibid.*, 1192.

billion Chinese citizens out of poverty.⁸⁸ Additionally, labor-intensive goods have the added benefit of employing a larger number of people than other sectors of the economy. Since one of the defining characteristics of many developing countries, especially the least developed countries, is a large amount of unproductive labor growing the labor intensive sectors of the economy is especially beneficial.⁸⁹

Liberalization is also directly beneficial to the poor because the bulk of the poor work in agriculture, one of the most protected sectors of the economy.⁹⁰ As protection in this sector is eased the rural poor, often the poorest in any given country, will see increasing market access, leading to increasing incomes. This can happen domestically, as when the removal of subsidies increases the price of goods, thereby increasing agricultural incomes. It can also occur internationally, as when the removal of import barriers provides access to new markets for farmers to sell their products. Such a process is not only beneficial to the farmers, however, as the eradication of protectionism also brings domestic prices of agricultural products closer to the world market price, thereby increasing market penetration by making goods accessible to people who previously could not afford them. Since higher costs associated with import barriers don't accrue to the consumer or the foreign producer, such a situation is a win-win for the impoverished consumer in the domestic economy and the impoverished farmer in the foreign economy.

⁸⁸ World Bank, "From poor areas to poor people: China's evolving poverty reduction agenda," *World Bank Poverty Reduction and Economic Management Department* (March 2009).

⁸⁹ Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*, 81.

⁹⁰ Arvind Panagariya, "Miracles and Debacles: Do Free-Trade Skeptics Have a Case?" 1192.

On top of the two direct benefits of trade liberalization for the poor, fast growth can be linked to poverty reduction in three indirect ways. First, the “pull-up” effect first proposed by Jagdish Bhagwati begins once an economy is growing sustainably at 3 percent or more. This pull-up effect is a rapid process of absorbing the unemployed poor and those employed in marginal jobs into gainful employment.⁹¹ While the extent to which the pull-up effect actually improves people’s condition can vary depending on the type of economic growth and the sorts of complimentary policies and institutions that exist, it is empirically true that fast growth (above 3 percent annually) does lead to poverty reduction through gainful employment.⁹²

Beyond pulling up the poor into sustained employment, countries that are growing economically see higher government revenues, which can be used to deploy poverty reduction programs throughout the country.⁹³ Such revenues can also be used for infrastructure, such as building quality roads to rural areas so that the rural poor may benefit from the gains of economic growth equally with the urban poor. While there is certainly no guarantee that a government will use its new found revenue for purposes that benefit the poor, the very fact that more resources are available to it makes proper use a greater possibility than behind protectionist walls where government revenue remains stagnant.

⁹¹ Jagdish Bhagwati, “Globalization With a Human Face,” lecture presented at *The Future of Globalization: Explorations in Light of Recent Turbulence* (Yale Center for the Study of Globalization and The World Bank: October 2003).

⁹² Ibid.; Also see Arvind Panagariya, “Miracles and Debacles: Do Free-Trade Skeptics Have a Case?” 1192.

⁹³ Arvind Panagariya, “Miracles and Debacles: Do Free-Trade Skeptics Have a Case?” 1192.

Finally, economic growth indirectly benefits the poor by increasing their ability to access public services such as education and healthcare. Because trade liberalization does create real income gains, it means families will have more money to access basic necessities, including healthcare and education. Such access has a few key benefits. It immediately improves the quality of life for the people by keeping them healthier. It also benefits them in the long-term by providing them with continual healthcare that makes their lives better and likely leads to a greater ability to engage in economic and social interactions because of improved health. As well, by providing access to education children are finally exposed to the sorts of tools necessary to ensure they live a life out of poverty in the future. Hands down quality healthcare and access to education are two of the most important components of people escaping the cyclical trap of poverty. Behind protectionist walls these gains may still accrue, but it is much less likely and requires additional costs that trade liberalization does not impose.

In this section I have emphasized the initial benefits of trade liberalization, such as lower prices for consumers and rapid positive economic turnarounds. Some of what I have said, such as trade liberalization's contribution to economic growth, is both an initial and long term benefit. But, overall, trade liberalization is more successful than economic protectionism at creating national wealth and the conditions to sustain growth. The upshot of all that I have said in this section is that arguments against trade liberalization on the basis of short term losses or displacement fail to take into account the entirety of the short term consequences of liberalization. While opposing an economic policy emphasizing long term development merely on the grounds of its short term harms is overall unsatisfactory, this section has indicated that such a position is not even

tenable. In the following section, then, I will emphasize the long term benefits of trade liberalization that compliment the short term gains.

2. Protectionism and Sustained Growth

Exploring short term costs and benefits of economic policy is certainly useful in choosing the best policy, but as any good development economist knows the real success and failure of any chosen development policy are its prospects for long term, sustained growth and development. Indeed, those in favor of protectionism will often accept that development policies such as import substitution do impose short term losses but will cling to the long term benefits to make the case for protectionism. Therefore, to successfully argue for the poverty of protectionism requires an in depth look at the ability for protectionism and free trade to produce long term, sustained growth and poverty reduction.

2.1. The Protectionist's Story

Development economics, as its name insinuates, is concerned with developing an economy into a stable, sustained system that returns real benefits to all those involved. The reason protectionism is so closely linked with development economics, then, is because it is viewed as the best method of developing an economy into a stable, sustained system that returns real benefits to all those involved. Indeed, development economists understand that such policies do impose short term losses, but their vestige of intellectual defense lies in the long term gains offered by protectionism. I want to focus on two more nuanced arguments in favor of protectionism. The first emphasizes the dependence that is built up when developing countries integrate into the global economy, which, it is argued,

works against long term development. The second is a more particularized version of the Infant Industry Protection argument that emphasizes imperfect information.

Dependency theory, generally speaking, is the theory that when more advanced nations involve themselves in the workings of less advanced nations those less advanced nations become dependent and therefore are unable to cultivate sufficiently independent economies that are not consistently held hostage by the whims of the advanced nations. Dependency theory has applied to imperialist and colonialist actions of the past, but it is now applied to “neo-colonialism”, that insidious new form of colonialism dominated by ideas rather than force.

“Dependent capitalism” is the form dependency theory takes on when applied to economic concerns. It consists in the developed world exploiting the developing world through appropriating its surplus value. The indicators of such exploitation, it is argued, can be found in the unequal exchange in trade between the developing and developed world. Such exploitation can only be remedied, it is argued, when the developing world “de-links” from the developed world, effectively closing itself off economically from the largest markets in the world.⁹⁴ It should be quite clear that such an argument finds its home mostly among the neo-Marxists, but such a view is certainly not limited to them.

Nobel Prize winning economist Sir Arthur Lewis put forth his own, more complex, view of dependency theory. His argument was that in an open economy the growth of the developing world was too heavily dependent on the external demand for its

⁹⁴ Deepak Lal, *The Poverty of 'Development Economics'*, (London, U.K.: The Institute of Economic Affairs, 2002), 91.

goods from the developed world. Such a situation militated against long term, sustained growth because the developing world would always only exist to provide goods to the developed world.⁹⁵ On the dubious assumption of unlimited labor in both the developed and developing world, and the assumption that the developing world would not be able to move into manufacturing exports due to never being able to compete in that sector with the developed world, Lewis concluded that the developing world would be unable to stabilize its terms of trade with the developed world, ensuring perpetual poverty.⁹⁶ Both assumptions have been proven empirically false, with the manufacturing sector actually being the *largest* sector of exports for the developing world and, as just one example, with China enjoying very positive terms of trade with the United States.⁹⁷

Despite questionable assumptions of Lewis' argument, it has in fact been quite influential among the anti-Globalization movement. Many continue to assert that the existing trade system leads to a pattern of specialization where productivity gains in the developing world's primary commodity economies are transferred to the developed world but the developed world's productivity gains in manufacturing are not transferred.⁹⁸ Again, such a view is empirically false in most situations, as the growth of the Far East economies clearly indicates first, that developing countries can break into the manufacturing sector, and second that through direct foreign investment technology transfers, which means productivity transfers, from the developed to the developing

⁹⁵ W.A. Lewis, "The Slowing Down of the Engine of Growth," *American Economic Review* 70, no. 4 (September 1980).

⁹⁶ Deepak Lal, *The Poverty of 'Development Economics'*, 85-86.

⁹⁷ 80 percent of the exports in developing countries are manufactures. Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*, 871.

⁹⁸ *Ibid.*, 62-63.

world do occur. Perhaps the worst assumption made by those arguing against trade liberalization on the grounds of dependency is that developing countries will always be stuck exporting only primary commodities – natural resources and agricultural products – and can't or won't move to more productive sectors such as manufacturing. Such a view, when held by leaders in the developing world, often turned out to be self-fulfilling prophecies as they neglected the sectors most important to growth, while those that opposed such a view and decided to engage the manufacturing sector despite being told they would fail have found the greatest successes.

The result of the application of dependency theory to economic engagement was support for particular inward looking policies such as import substitution. Indeed, anti-free trade analysts will often point to the growth in the developing world between 1960 and 1973 as a great period of growth marked by heavy emphasis on import substitution. Specifically, that period is defined by the greatest number of developing countries experiencing growth rates of at least 3 percent. The use of such data is very misleading, considering the sheer number of countries doesn't equate to a great level of actual people benefitting, as many of the countries were very small in terms of both population and GDP. In comparison, between 1984 and 1994 there were a greater number of actual people living in developing countries that were growing at 3 percent or greater and thus more impoverished people actually benefitting from growth. That period is defined not by import substitution, but rather by outward-looking policies including trade

liberalization.⁹⁹ Nonetheless, such empirical evidence was used to bolster theoretical claims about foreign-exchange bottlenecks.

According to those in favor of import substitution, if a developing country were to liberalize its trade policy and begin importing its intermediate goods, a foreign-exchange bottleneck would result, stalling growth and development. Such a bottleneck results, it is argued, when a country is unable to grow its exports because it will not have the foreign currency necessary to purchase additional inputs, which would be necessary to produce more exports and therefore grow.¹⁰⁰ Of course the biggest problem with such a view is that it assumed the ratio of inputs to output remained proportional, which is simply not the case as efficiency and productivity gains can succeed in altering that ratio. Thus, it is in fact possible for a country to grow its exports absent importing a greater amount of inputs. The result of all of these arguments, consistently based on patently false assumptions, has been that much of the developing world was unable to fully reap the benefits of periods of great economic growth worldwide. The countries that fully embraced such poor doctrines are those very same countries that are now often pointed to by anti-Free Traders as the ones punished by open markets. Unfortunately, much of the suffering they incur now is the result of poor decisions made by the country's leaders in the past.

If the underlying assumptions of dependence capitalism were correct, then such a theory would give pause to the arguments in favor of trade liberalization. Certainly, such proclaimed harms to long term, sustained growth resulting from trade openness would

⁹⁹ Arvind Panagariya, "Miracles and Debacles: Do Free-trade skeptics have a Case?" 1176.

¹⁰⁰ Deepak Lal, *The Poverty of 'Development Economics'*, 64-66.

make its adoption quite problematic. But a second argument against open trade on the basis of sustained growth may in fact do a better job of critiquing open trade policy. While the traditional defenses of infant industry protection point to learning-curve effects and the need to develop a base of applicable skills prior to forcing corporations to compete internationally, some have argued for such protection on the grounds of imperfect information.¹⁰¹

According to this particular argument, protection of infant-exporters is a first-best policy measure when actual consumption experiences are required to learn about a commodity's quality.¹⁰² Put simply, protection is justified when a firm suffers from a lack of a reputation and it isn't capable of improving that reputation except through having actual consumers purchase its goods. Such an argument appears to have particular relevance for several manufacturing industries including personal computers, consumer electronics and automobile parts because of the importance of "brand names" in these sectors.¹⁰³

Additionally, this argument relies on some of the same standard arguments for infant industry protection, namely the existence of externalities. Thus, when the social returns on investment in foreign market cultivation exceed the private returns, based on the assumption that firms only make decisions on short-run profit considerations,

¹⁰¹ Gene M. Grossman and Henrik Horn, "Infant-Industry Protection Reconsidered: The Case of Informational Barriers to Entry," *The Quarterly Journal of Economics* 103, no. 4 (November 1988): 767-787. 767.

¹⁰² Wolfgang Mayer, "The Infant-Export Industry Argument," *The Canadian Journal of Economics* 17, no. 2 (May 1984): 249-269.

¹⁰³ Gene M. Grossman and Henrik Horn, "Infant-Industry Protection Reconsidered: The Case of Informational Barriers to Entry," 768.

government intervention is justified to help the society as a whole.¹⁰⁴ Even the great free trader Jagdish Bhagwati has stated that such a justification based on externalities may justify export subsidies (although not necessarily other forms of protection).¹⁰⁵

The basis of the theory falls closely in line with what I have been arguing protectionists are required to do to justify their views. Namely, defenders of infant industry protection due to imperfect information are clear that “in general, export subsidization results in significant short-run welfare losses to society as a whole and to many individuals in this society.”¹⁰⁶ This falls well in line with what I have said elsewhere and will continue to discuss later. Nonetheless, the defenders continue to justify the protection on the grounds that doing so will result in long term benefits on two counts: The existence of externalities due to growing the industry and penetrating a foreign market, as well as the eventual ability to affect the foreign demand price once foreign markets become sufficiently familiar with the products.¹⁰⁷

Problems certainly arise with both of these mechanisms, however. In terms of externalities, Mayer’s analysis in favor of protection relies on the assumption that consumers do not associate reputation with individual firms, but rather with countries.¹⁰⁸ Thus, when we decide to buy a Hyundai car we are not doing so based on the reputation of Hyundai, the Korean company, but rather on the reputation of Korea, the country.

¹⁰⁴ Wolfgang Mayer, “The Infant-Export Industry Argument,” 249-250 and 254.

¹⁰⁵ Jagdish Bhagwati, *The Theory and Practice of Commercial Policy: Departures from Unified Exchange Rates* (Princeton, NJ: Princeton University Press, 1968).

¹⁰⁶ Wolfgang Mayer, “The Infant-Export Industry Argument,” 267.

¹⁰⁷ *Ibid.*, 256.

¹⁰⁸ Gene M. Grossman and Henrik Horn, “Infant-Industry Protection Reconsidered: The Case of Informational Barriers to Entry,” 769-770.

Thus, he assigns a greater value to the externalities of infant industry protection than may be justified, as it appears to be true that consumers do assign reputation to individual firms, not necessarily countries as a whole.

In terms of the second mechanism, whereby the firms will gain some control over the foreign demand price due to familiarity, there are no implicit assumptions that make it problematic. However, Mayer is honest in arguing that such gains due to this mechanism accrue only to people involved, directly or indirectly, with the particular firm or industry. Specifically, he tells us that it is:

Quite possible that some people experience a gradual erosion of their well-being, the decline in their income share being the prevalent force. Such losers will be found among people whose ownership ratio of the infant-export industry's intensively used factor is extremely low.¹⁰⁹

Factors, in this context, consist in the amount of resources, including land, labor and capital, available for a particular industry. Thus, Mayer's statement is effectively that those people who do not have direct ties to the particular firm or any ancillary firms (such as service firms that provide support or firms producing intermediate goods for that firm) won't just be left out, but made worse off by protectionist policies. This is not necessarily just a short term loss; as he tells us that the experience may be a "gradual erosion of their well-being". They may indeed never receive any long term benefits that can be said to outweigh the accrued losses.

The questionable assumptions and undesirable consequences of Mayer's analysis of imperfect information and infant industry protection should be reason to reject such

¹⁰⁹ Wolfgang Mayer, "The Infant-Export Industry Argument," 266.

policy prescriptions. Nonetheless, the infant industry argument in general, and basing it on reputation in particular, has been extremely influential in development economics and indeed in the development policies pursued by many developing countries over the past few decades. As such, it stands as one of the cornerstones of the protectionist's case against trade liberalization. However, as I will argue in the next few sections, protectionism fails on many counts to provide for sustained growth and trade liberalization, in fact, provides the best hope of long term sustained growth and poverty reduction.

2.2. Protectionism and Competition

It is uncontroversial to claim that protectionism limits competition. Protectionism, if it works, works because it limits competition. While those in favor of protectionism would have no problem admitting that it limits competition, they fail to understand both the theoretical and empirical benefits of economic competition for long term growth. Indeed, by limiting competition to encourage industrial development protectionism actually discourages long term, sustained growth and development.

The benefits of competition are well stated in the economics literature. It forces firms to lower their prices, increase their quality and while some firms will lose, the winners will be in the best position possible to succeed both internationally and for the long term.¹¹⁰ Indeed, without punishment for failing to become more efficient, firms have absolutely no motivation to improve. In the market such punishment is the loss of

¹¹⁰ Mark J. Roberts and James R. Tybout, *Industrial Evolution in Developing Countries: Micro Patterns of Turnover, Productivity, and Market Structure* (New York: Oxford University Press for the World Bank, 1996).

business or even the complete collapse of the firm. But in a protected market there is a guaranteed consumer base that is forced to pay the higher prices necessary for an inefficient industry to stay afloat. The stated goal of many protectionist policies is to give inefficient industries time to become more efficient before being required to openly compete, and this can work with enough political will, as it did in South Korea, but it is both theoretically and practically difficult.

The theory for increases in efficiency behind trade barriers relies on a country's government being stable and strong enough to impose requirements on its provision of protection.¹¹¹ For instance, the strong military dictatorships in South Korea that dominated politics between the 1960s and 1980s did impose temporary and declining barriers to trade to encourage the development of indigenous industries. However, the government was intimately involved in the development process of particular firms and was able to make legitimate threats to particular firms for failure to improve efficiency and productivity.¹¹² Theoretically, then, protectionism can replace the benefits of open competition by imposing particular requirements on firms that must be met to continue receiving government protection. Even in this situation, however, open competition would be a more effective method of achieving efficiency gains. This is because even a government with the political will to take away protection will always be of two minds on the subject. It is consistently interested in development of the country's economy, and if it is forced to take away the protection from a particular industry due to it failing to grow appropriately, then it is ensuring even slower development of the country's

¹¹¹ John Roberts, "What Should We Think About Infant Industry Protection?" 5.

¹¹² Robert Hunter Wade, "Reply to John Roberts on Infant Industry Protection," 11-12.

economy. Even if protection will shift to a new industry, there is a period of national loss. This does not occur with open competition, however, as firms compete with only one goal in mind. The firm is interested in surviving and growing, regardless of what happens to other firms or even the country as a whole. Thus, real open competition between firms is a more effective method of promoting efficiency than government protection.

The above indicated the theoretical difficulties with using protectionism to improve efficiency, but this concern can be bolstered by examining some practical difficulties. There are two ways in which protectionism fails in practice to achieve gains in efficiency: first, by often not being temporary and thus taking away all reason for a firm to increase efficiency, and second by examining the case of India's manufacturing sector, where after decades of protection followed by eventual removal of barriers the sector remained inefficient and uncompetitive.

It is a quite well established truth that the governments of developing countries, especially the least developed, are weak and corrupt.¹¹³ This weakness and corruption militates against the beneficial use of protectionism by making government threats lack any legitimacy as well as increasing the risk that government bureaucrats may undercut general government policy, thus making threats that are seemingly upheld meaningless in practice. Such practical concerns strengthen the theoretical worries, since the theory of efficiency through protection is deeply reliant on the protection being contingent on meeting particular goals and must necessarily be temporary. So while I have already shown that even in the ideal case protectionism is only a second-best option to open

¹¹³ Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It* (New York: Oxford University Press, 2007), 64-70.

competition, once we move to real cases of protectionism we find that not only is protectionism not a second-best option anymore, but it is in fact a great harm. If protection is not contingent on achieving greater efficiency then no real, long term benefits of development will accrue and the consumer, that is everybody, will still be paying a premium on goods they could receive cheaper. Thus, all the costs of protectionism manifest while none of the possible benefits come about.

India provides a perfect comparative study of protectionism and free trade. India maintained extremely high trade barriers on its manufacturing sector for decades up until the early 1990s. During that time, it saw no increases in living standards for its people and no growth in efficiency in that sector.¹¹⁴ After major trade reforms India was left with a manufacturing industry woefully behind the rest of the world in productivity that was unable to compete on the world market and therefore left India less developed than it otherwise could have been. The situation is now getting better, as the forced competition due to trade liberalization is requiring the Indian manufacturing industries to improve efficiency to compete. The result has been a 20 percent increase in aggregate productivity growth, a 30-35 percent increase in intraplant productivity and a reduction in poverty from 45 percent in 1983 to 26 percent in 2000.¹¹⁵

All the above gains only occurred after the liberalization of the early 1990s, but another Indian sector, information technology, has consistently grown and made India a frontrunner in that sector. The reason India has been so successful in this more recent

¹¹⁴ Douglas Irwin, *Free Trade Under Fire*, 194.

¹¹⁵ T.N. Srinivasan and Suresh Tendulkar, *Reintegrating India With the World Economy* (Washington, D.C.: Institute for International Economics, 2003). Also see World Bank, *India: Sustaining Reform, Reducing Poverty* (Washington, D.C.: World Bank, 2003).

sector of the economy is that it never allowed the sector to grow behind protectionist barriers, but has, since its inception, required it to compete on the open market and thus forced gains in efficiency. As a result, India has become a leader in the information technology sector, while it still remains to some extent uncompetitive and backwards in the manufacturing sector.¹¹⁶ The upshot of this comparison is that not only is protectionism unlikely to actually produce efficient, competitive industries, but also that trade liberalization and the competition that accompanies it is in fact an effective way of producing internationally competitive industries and achieving real poverty relief.

In this section I argued that by limiting competition, protectionism limits the ability for a country to sustainably develop efficient, competitive industries that will ensure both economic growth and poverty reduction for the long term. I analyzed and rejected the argument that protectionism, if done within particular constraints, can promote gains in efficiency and therefore produce competitive industries before making them compete. I additionally discussed the practical difficulties with achieving anything close to the theoretical model of perfect protection, concluding that empirically trade liberalization has done a great deal more than protectionism for producing competitive industries that produce long term socio-economic benefits.

2.3. Protectionism and Intermediate Goods

I previously argued that protectionism harms the possibility of sustained growth by limiting competition and thereby limiting the most important guiding force behind gains in efficiency and productivity. In certain situations, indeed the majority of actual

¹¹⁶ John Roberts, "Infant Industry Protection—A Rejoinder," in Adrian Wood, "Symposium on Infant Industries," *Oxford Development Studies*, 31, no. 1 (2003): 3-20, 19.

cases, protectionism militates against sustained growth by imposing barriers on “intermediate goods”. Intermediate goods are those goods that are not provided to the consumer in the end, but are necessary components of final goods or their production. Prime examples of intermediate goods are steel, lumber and even partly developed parts such as car engines. Additionally, machinery and other technology used for production, sometimes considered capital goods, are also intermediate goods. Some products, such as sugar, exist as both final and intermediate goods. One of the most important aspects of intermediate goods is that because they are used by producers as inputs for many different products, any increase in cost of the intermediate good radiates out to a greater portion of the economy than any increase in cost of a final good.¹¹⁷

Tariffs on final goods may be said to be most harmful to the consumer, who is forced to pay a higher price for the good. Tariffs on intermediate goods, however, are quite harmful both to the consumer and many local producers. Thus, barriers imposed on intermediate goods are doubly harmful to development and poverty relief, by imposing short term financial losses on consumers and long term financial and productivity losses on producers. For instance, the same trade reforms in India that finally gave its manufacturing sector a chance to grow also resulted in a new found ability to import many intermediate goods previously unavailable to the economy. The average tariff rate on all intermediate goods was reduced from 150 percent in 1985 to 30 percent by 1997, resulting in a doubling of imports of intermediate goods. Such importation led to falling prices and gave the manufacturing sector the ability to import new components and

¹¹⁷ Douglas Irwin, *Free Trade Under Fire*, 86.

materials for new product lines and more efficient processes.¹¹⁸ Thus the poverty reduction numbers I gave previously, a reduction of 19 percent during the 1990s is attributable to both requiring the manufactures sector to compete internationally and giving it the means to do so.

India provides a clear example of the benefits of liberal trade in intermediate goods, but any development strategy should recognize the importance of cheap inputs. The goal of any development policy is the development of indigenous industries capable of sustaining economic growth for the nation, through at least the national market, but more often the international market as well. One of the keys to doing this, especially with an infant industry, is providing cheap inputs wherever possible.¹¹⁹ It may not be possible for certain inputs to come all the way down to the international market price even with free trade, due to transportation costs, but erecting barriers to the importation of cheaper intermediate goods is a sure way to stymie the international competitiveness of fledgling industries. Therefore, a policy of imposing trade barriers on intermediate goods is a poor policy for development and poverty reduction.

2.4. Protectionism and Export Performance

The third and final way in which protectionism harms the prospects of sustained growth and poverty reduction is through its indirect effects on export industries. While limiting competition and erecting barriers to the importation of intermediate goods harm exports by making it difficult for indigenous industries to break into the international

¹¹⁸ Daniel J. Ikenson, "A Protection Fling: Why Tariff Hikes and Other Trade Barriers Will be Short-Lived," *CATO Institute Center for Trade Policy Studies Free Trade Bulletin*, no. 37 (March 12, 2009).

¹¹⁹ Rudiger Dornbusch, "The Case for Trade Liberalization in Developing Countries," 74.

market, protectionism also has a more indirect way of harming exports. According to the Lerner Symmetry Thesis, a tax on imports is equivalent to a tax on exports, in terms of the effect on the economy.¹²⁰ It is because of this equivalence that import barriers have an indirect and often unintended impact on exports, creating a situation that is not conducive to long term, sustained growth.

The basis of the Lerner Symmetry Thesis lies in an understanding of how imports and exports influence currency valuation and relative prices. In economics the emphasis is on relative prices as opposed to the absolute level of any single price. This is because input costs and consumption costs can be altered by the prices of other goods. Thus, of concern to understanding how a country is doing economically is not the absolute value of its imports or its exports but rather the relative price of importables to exportables, also known as a country's terms of trade.¹²¹

A country's terms of trade, measured as a ratio of its exports to its imports effectively indicates the value of what it must export in order to pay for what it imports. Generally, a higher number for the ratio is considered beneficial, as it indicates the country is paying less (relatively) for its imports. However, what this formula also indicates is that if a country either pays more for its imports (due to import tariffs) or receives less for its exports (due to export taxes) the result is the same: deterioration in its terms of trade. So, if a country currently pays out \$1,000 in exports to receive \$1,000 in imports, its terms of trade is exactly 1, or 100 percent. Now, whether it imposes a 30

¹²⁰ Dani Rodrik, "The Rush to Free Trade in the Developing World: Why so Late? Why Now? Will it Last?" *National Bureau of Economic Research Working Paper*, no. 3947 (January 1992). 20-21.

¹²¹ *Ibid.*, 18.

percent import tariff (resulting in \$1,300 on the bottom of our calculation) or a 30 percent export tax (resulting in \$700 on the top of our calculation) the result is roughly the same. \$1,000/\$1,300 produces a ratio of roughly 3:4, while \$700/\$1,000 results in a ratio of about 7:10. Thus, either through import or export taxes a country succeeds only in harming its own terms of trade.

This phenomenon can also be explained by appeal directly to currency valuation. As a country limits its imports, it keeps more of its currency in the domestic market. Similarly, as a country limits its exports, it reduces the amount of foreign currency in the domestic market. In either situation, currency values will alter in harmful ways for the country. If more of its own currency is kept within the country then its value will rise in comparison to its trading partners. When a country's currency value increases it makes it more expensive for foreign nations to purchase that country's exports.¹²² Instead of one U.S. dollar equaling one Euro, it would be like one U.S. dollar equaling two Euros. While this sounds beneficial, and it can in fact be in particular situations, it is not beneficial for a country seeking to develop quickly. Now our European friends must pay double the amount to purchase the same American good, and that will necessarily lead to declining American exports. On the opposite end, when a country's currency loses value it makes its goods relatively cheaper, encouraging exports.¹²³ So, in this situation our European friends would be able to buy American goods cheaper, say for 0.75 Euro on the dollar, encouraging them to purchase more from America than elsewhere (including the domestic market) because of the favorable terms.

¹²² Rudiger Dornbusch, "The Case for Trade Liberalization in Developing Countries," 71.

¹²³ Dani Rodrik, "The Rush to Free Trade in the Developing World: Why so Late? Why Now? Will it Last?" 21.

This intimate link between imports, exports and currency valuation is what drives the liberal economic belief that increasing imports, even to the point of harming a country's terms of trade, can be a benefit to the country's development.¹²⁴ By removing all barriers to imports, a country encourages the purchase of the imported goods, resulting in the domestic currency leaving the domestic market. In turn, the countries that had been exporting to the developing country have greater reason to import goods from it than other alternatives, as the goods will be cheaper. Since this grows the export sector, the terms of trade will eventually balance out, but in the short run the export industries are able to compete without artificial market manipulation, improve efficiencies and also import all the necessary intermediate goods at lower prices. Indeed, it is through a fully open market that rapid, sustained growth can be achieved, and with it, rapid, sustained poverty reduction.

The above theoretical tradeoff between imports and exports has an additional, more grounded consequence. Not only do import barriers harm the export industry by limiting its access to external markets, but import barriers in fact reduce the jobs and companies engaged in the export sector. Thus, while instituting a policy of import substitution may succeed in creating jobs in certain infant industries catering to the domestic market, it actually leads to job loss in the exporting industries that are more important to sustained growth and development. This is why import barriers have never succeeded in creating jobs, because any gains in protected industries are offset by losses

¹²⁴ Douglas Irwin, *Free Trade Under Fire*, 82-84.

in employment in export-oriented industries.¹²⁵ Thus, not only do barriers to trade harm the country's long term prospects of employment growth by killing the very industries that would best provide for long term growth, but they also produce no positive employment benefits even in the short term. Without netting positive job growth it will hardly be possible for a developing country to pull its people out of poverty, as one of the major problems in many of the poorest nations is a lack of gainful employment in formal economic sectors. A lack of available jobs results in people working in illicit or informal sectors of the economy. These endeavors not only put them at risk of abuse but also often work against government and nationwide stability, which is a cornerstone of sustained economic growth. Protectionism, then, is not conducive to successful growth and poverty reduction because it cannot create jobs, in the short or long term, and also harms a country's prospects of sustained growth by indirectly taxing the export sector.

2.5. Free Trade, Sustained Growth and Poverty Reduction

Nobel Prize winning economist Paul Krugman famously asserted that “productivity isn't everything, but in the long run it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker.”¹²⁶ Such a claim is uncontroversial among economists, whether they promote protectionism or free trade. Indeed, the goal of nearly all development policies, whether they include open markets or government intervention, is to improve productivity and efficiency. Sustained poverty reduction requires sustained growth and sustained growth requires improvements in productivity and efficiency, as

¹²⁵ Douglas Irwin, *Free Trade Under Fire*, 86.

¹²⁶ Paul Krugman, *The Age of Diminished Expectations: US Economic Policy in the 1980s* (Cambridge, MA: MIT Press), 9.

well as increasing exports. Thus, in this section, I will argue that free trade is the best means to productivity gains and increasing exports. I will then conclude with an analysis of how sustained growth benefits the poor for the long run.

I have already discussed the productivity problems associated with trade barriers in the previous sections, so here I will emphasize a positive case for trade liberalization's benefits to productivity. The main focus of such a case is on the benefits of open competition, something that only free trade can provide. Indeed, a major survey of worldwide country studies found that "in *every* country studied, relatively high industry-wide exposure to foreign competition is associated with lower [price-cost] margins, and the effect is concentrated in larger plants."¹²⁷ The empirical data linking competition to productivity gains is colossal, but free trade's benefit to productivity doesn't end there. On top of forcing improvements through competition, free trade makes the means to improve productivity more widely and cheaply available. Free trade improves resource allocation, creates access to better and more technologies and inputs, and opens up the ability for knowledge to transfer from more advanced nations to developing ones.¹²⁸

I have discussed some of the ways free trade opens channels to productivity gains above, so here I want to focus on the transfer of technology and knowledge. Developing countries, especially the least developed, often suffer greatly from a lack of educated people and advanced technology. Free trade, as opposed to protectionism, is capable of overcoming these pitfalls quickly through both the trade in goods and the increased

¹²⁷ Mark J. Roberts and James R. Tybout, *Industrial Evolution in Developing Countries: Micro Patterns of Turnover, Productivity, and Market Structure* (Oxford: Oxford University Press, 1996). 196.

¹²⁸ Rudiger Dornbusch, "The Case for Trade Liberalization in Developing Countries," 73-74.

access of foreign, likely more advanced, firms into the nation. Indeed, when a nation opens itself to foreign investment firms that move in are often moving in with all the technology and knowledge necessary to succeed, but it must transfer such technology and knowledge to its workers, and thus the nation as a whole. Although the government can adopt a program of vocational training behind trade barriers, if the skills are new to the nation, there won't necessarily be anyone to teach the skills. Therefore, opening up to foreign firms provides quicker and better access to skills training. Such training is often useful for more than the original industry that trained the individuals, and thus as more people gain the proper technical training not only do the particular industries they are training for become more productive and profitable but new industries become possible because the skilled workforce will already exist.

The transfer of knowledge should not be understated. Not only does it turn unskilled labor into skilled labor, but it also involves the transfer of management techniques and methods of efficient production. It creates an atmosphere conducive to entrepreneurship and provides access to the means of achieving real business success. Even in situations where the situation for workers starts off poorly, as in "sweatshops", free trade has built in mechanisms to evolve industries from low productivity, low wage sweatshops into high productivity, high wage industries. And knowledge doesn't leave even if the industry does. Put simply, the key to sustained economic growth lies in having the knowledge and technology to break into new markets and consistently improve existing ones, and free trade provides such knowledge.

Free trade also provides important benefits to a nation's technology. This can be done in two ways: either through improving knowledge, which results in indigenous

technology breakthroughs, or through direct transfer of technologies through, mainly, capital goods. To recall, capital goods are the goods necessary for production of other goods. These are not inputs, like how sugar is an input for candy. Rather, capital goods include the machinery necessary to turn the sugar into candy. Protectionism often increases the costs of capital goods, while free trade both decreases their cost and, through the promotion of direct foreign investment, may succeed in bringing the technologies into the country free of charge. Capital equipment is closely linked with productivity and growth, as about a quarter of the differences in productivity across countries is attributable to differences in the price of capital equipment.¹²⁹ For countries that don't have the ability to complete much technological research themselves, free trade offers the opportunity to purchase technological advancements when protectionism would often prohibit such transfers.

Productivity gains, then, ensure sustained economic growth. But as Krugman pointed out, productivity gains aren't just about creating a better economy but are vital to improving the standard of living within a country. An economy's productivity level is directly tied to its standard of living. As productivity increases workers can work the same amount of hours but produce more, therefore resulting in higher wages.¹³⁰ As these productivity advancements continue workers are also able to work fewer hours while still making more money. Indeed, the success stories of the past fifty years make it quite clear

¹²⁹ Jonathan Eaton and Samuel Kortum, "Trade in Capital Goods," *European Economic Review* 45 (2001): 1195-1235. Also see Jong-Wha Lee, "Capital Goods Imports and Long-Run Growth," *Journal of Development Economics* 48 (October 1995): 91-110 and Joy Mazumdar, "Imported Machinery and Growth in LDCs," *Journal of Development Economics* 65 (June 2001): 209-224.

¹³⁰ Douglas Irwin, *Free Trade Under Fire*, 46.

that low wages succeed in bringing in industries, and as more competitive industries move in and productivity increases higher wages necessarily follow.¹³¹

China is illustrative of this process. China's economic growth began, as it does in most every developing country, with labor-intensive manufactures. These industries require the least amount of skilled labor while also employing a large number of people. But since these are generally unskilled or low skilled jobs they also tend to be some of the lowest paying industrial jobs. However, as China has grown it has begun to lose its comparative advantage in these industries due to increasing wages. But China's growth isn't slowing; instead it is shifting to more sophisticated goods with greater efficiencies. These industries require more skill and also have higher price margins and thus can employ people for the higher wages that are being demanded.¹³²

Productivity gains among firms are also cumulative. "Economies of agglomeration" come into existence when many similar manufacturing firms situate themselves in close proximity. The result is a decrease in costs for all firms, a sharing of a large pool of workers, increased access to cheaper inputs and service firms, and increased competition which lowers prices for the consumer.¹³³ If productivity is "almost everything" when it comes to improving standards of living, and indeed it is, then open trade becomes a necessity, as it provides countless benefits to a nation's economic productivity. Simply by reforming trade policies, as the Ivory Coast did in 1985, a

¹³¹ Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*, 83.

¹³² Douglas Irwin, *Free Trade Under Fire*, 37.

¹³³ Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*, 82-83.

country can succeed in raising its economic productivity. Indeed, the Ivory Coast's experience is telling: productivity growth tripled on average, with four times more rapid growth in the least sheltered industries.¹³⁴

Open trade not only promotes gains in productivity. It also leads to more competitive export industries through lifting the actual barriers to input goods and the implicit barriers to exports that coincide with import barriers. By making intermediate goods cheaper, including both inputs and capital goods, trade liberalization decreases the costs of final goods as well as aiding in gains in efficiency. In fact, even if a country fails to open its economy to imports of final goods, it can see great economic and social gains by lifting the barriers to imports of intermediate goods. A reduction in import duties on intermediate goods has been empirically linked to a 1 percentage point gain in GDP growth, and as the reductions increase so do the benefits to economic growth.¹³⁵

The impact of trade liberalization on intermediate goods is threefold: it makes intermediate goods cheaper, it allows for higher quality intermediate goods and it increases the variety of intermediate goods. These three factors come together to promote sustained economic growth and poverty reduction. The cost reductions are clear; lifting import tariffs on intermediate goods will necessarily make them cheaper, as well as increasing variety by making some previously uneconomical imports economical. Higher quality goods arise because they become economical once barriers are lifted as well.

¹³⁴ Douglas Irwin, *Free Trade Under Fire*, 48.

¹³⁵ Antoni Esteveordal and Alan M. Taylor, "Is the Washington Consensus Dead? Growth, Openness, and the Great Liberalization, 1970s-2000s," *National Bureau of Economic Research Working Paper* 14264 (August 2008).

Finally, variety is increased because more goods become economical but also because as new industries arise demand for different intermediate goods increases.

These increases in goods with lower costs are a massive boon for productivity gains. Indeed, increasing the variety of inputs is more conducive to productivity gains than simply increasing the quantity of a narrow range of inputs.¹³⁶ The result is that a country can easily become an exporter of labor intensive tasks and set the stage for gradual shifts to higher value-added tasks. But a wide variety of cheap inputs is critical to such success, as it massively increases the economic possibilities. When new inputs are introduced to the economy the production of new final goods become possible, therefore allowing for new opportunities for economic growth as well as economic diversification, which is vital to ensuring growth isn't absolutely destroyed by a single price shock. Thus, again, the benefits of free trade are cumulative; cheaper inputs make previously inefficient industries efficient, which in turn brings more money into the country to purchase a wider variety of inputs, which in turn allows for industrial diversification, and the process continues. According to one economic researcher "access to a variety of foreign inputs at a lower cost shifts the economy-wide production function outward, which illustrates a concrete link between productivity and the trade regime."¹³⁷

The justification for an outward oriented economy is quite commonsensical. If a country is focused outward the prospects for growth are much less limited than if it is inward focused. One of the major reasons import substitution and other inward oriented economic policies consistently fail to lift people out of poverty is that such a development

¹³⁶ Rudiger Dornbusch, "The Case for Trade Liberalization in Developing Countries," 74.

¹³⁷ Ibid., 74.

policy is not sustainable. Economic growth will necessarily hit a ceiling domestically, but there is either no such ceiling internationally or it is a great deal higher. Empirical studies reinforce this point:

Thus, the outward-oriented Far Eastern economies, which either pursued free-trade policies (Hong Kong and Singapore) or offset the anti-trade bias of their protection through export subsidies (Republic of Korea and Taiwan) managed to register a huge export performance whereas protectionist countries like India hurt their own export, and hence economic, performance. But both sets of countries faced virtually the same trade protectionism abroad! The postwar experience underlines strongly the proposition that export pessimism is self-fulfilling whereas those who set their policies to exploit foreign markets have usually found it possible to do so despite protectionism abroad.¹³⁸

Two points should be made about the above statement. First, the authors note that some of the Far Eastern economies actually pursued free trade policies while others maintained at least some protectionist barriers but countered the implicit tax on exports that coincided with the import barriers to ensure they were still outward oriented. Clearly Hong Kong and Singapore pursued a better policy here, as all four countries mentioned found economic success but Korea and Taiwan both had to make use of government payouts and market manipulation to ensure they succeeded, whereas Hong Kong and Singapore succeeded without additional administrative costs. Second, the reference to “export pessimism” requires clarification. After World War II there was great backlash to the orthodox view that countries should have an outward-oriented economic development focus. Collapsing prices of primary commodities (namely natural resources), which at the time were considered the major way for developing countries to break into the market, led to new development theories focused on inward-oriented economics. History has been

¹³⁸ Jagdish Bhagwati and Arvind Panagariya, “Wanted: Jubilee 2010 Against Protectionism,” *International Trade*, EconWPA (2003), 5.

unkind to such thinking, however, because the countries that followed the new orthodoxy failed to develop while those that shirked the new theories for the old, such as the nations of East Asia, found great success.

As I have already mentioned numerous times, the economic successes of the East Asian nations coincided with social successes, namely massive reductions in poverty, even to the point of eliminating it on certain criteria. Trade liberalization and the sustained growth it brings along with it is invaluable to efforts at poverty reduction, and such sustained growth often casts a wide net for its benefits. Indeed, an export-oriented economy focusing on labor-intensive goods such as manufactures and services provides the most rapid absorption of unproductive labor into the productive economy, and thus provides the greatest number of people and families with a chance to escape the chains of poverty.¹³⁹

The final key point that needs to be made here is that the benefits of trade liberalization also reach beyond national bounds. Certainly open economies grow faster and more sustainably as well as reduce poverty. Open economies are also good markets for other nations. It used to be the case that developing countries that opened up became markets primarily for developed countries, but more recently trade between developing countries has been rapidly increasing. As of 2003, 40 percent of developing country exports went to developing markets.¹⁴⁰ What this means is that the win-win scenario trade liberalization brings with it is doubly helpful for efforts at poverty reduction, as

¹³⁹ Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*, 81.

¹⁴⁰ John Roberts, "What Should We Think About Infant Industry Protection?" in Adrian Wood, "Symposium on Infant Industries," *Oxford Development Studies* 31, no. 1 (2003), 7.

developing countries open up to each other so that both markets grow. Indeed, the rise of trade between developing countries led researchers for the World Bank to conclude that “biases against developing country exports are in developing economies’ tariffs as much as in the developed economies’ tariffs.”¹⁴¹ While true open trade requires the opening of all markets, and certainly the developed world would do well both for themselves and the developing world by removing its barriers to trade, the benefits of unilateral barrier reduction by the developing world cannot be understated. Even without concessions by the developed world, the developing world can succeed in rapid, sustained growth and poverty reduction by adopting intelligent economic policies, including trade liberalization.

3. Protectionism and Bad Governance

Economic concerns have always been closely connected with political ones. A government can both provide the necessary policies for successful economic growth as well as provide the policies that prevent it. Indeed, bad governance is often tied to poor economic performance, as the corrupt leaders steal money and goods that should be going to the country’s citizens. The impact governance on economic performance should not be understated, but there is a clear asymmetry in how governance relates to economic performance. No matter how good the government is, there is a pretty strict ceiling to the amount of economic benefits it can provide. This is simply because economic growth beyond 10 percent appears unsustainable. However, the poor economic consequences of bad governance are effectively a bottomless pit. A perfect government may fail to turn its

¹⁴¹ J. Michael Finger and Ludger Schuknecht, “Market Access Advances and Retreats: The Uruguay Round and Beyond,” *World Bank Working Paper* 2232 (November 1999), 4.

country into an economic powerhouse due to conditions outside of its control, but a corrupt government can certainly succeed in turning the most prosperous of nations into global paupers.¹⁴² Therefore, the asymmetry lies in the fact that bad governance knows no bounds but good governance does cap out in its benefits for the economy.

In this section I don't intend to focus on the benefits and harms of governance for economic performance, but rather I aim to answer the inverse question: what effect does economic performance have on governance? In answering that question I will discuss the protectionist's view that government is more trustworthy than corporate interests before arguing how protectionism actually contributes to poor governance at multiple levels. I will then end this section, and the chapter, with an analysis of the benefits trade liberalization and economic growth provide to good governance and how that influences efforts at poverty reduction.

3.1. The Protectionist's Story

The protectionist's story when it comes to bad governance and human rights is quite well known. Indeed, many protestors at the Seattle meeting of the World Trade Organization made such concerns globally known. Those that oppose globalization in general and free trade in particular, emphasize the amoral (or possibly immoral) nature of the global market system. Sure, it may produce wealth, but it is indifferent to whether that wealth is concentrated in a select few or disbursed evenly throughout the globe. Often without the slightest understanding of the famous "invisible hand" arguments of Adam

¹⁴² Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*, 64.

Smith, the protectionist asks “how is it possible that good outcomes could result from the pure self-interest that guides economic engagement?”

In place of market forces, the protectionist finds hope that the government will actually enforce rules, protect individual liberty, and create a unified development scheme that will succeed in raising impoverished nations out of their poor conditions. Unfortunately such hope is often misplaced, as the governments of many developing countries, especially the least developed, are often the most corrupt and abusive. Putting control of the economy in their hands is not the path to limiting abuses and reducing poverty, it is in fact the main way of ensuring such abuses and the continuance of poverty.

The argument against market forces usually takes one of two main courses: either markets are not sufficiently sensitive to the needs of a developing economy, or markets result in poor distribution schemes. In either case, it is argued, empowering the government to intervene in the market can successfully counteract such harms.

Capital markets, which constitute the availability of investment for new economic endeavors, are often weak and poor in developing countries. The result is that the capital market, which should be the engine of new economic opportunities, often doesn't take sufficient risk on many economic opportunities that would supposedly benefit the country. Thus, in order for a country to even have a chance of successful development the government must intervene through loans and protective barriers. For instance, the use of export subsidies may be justified when capital markets fail because they will provide for the early capital necessary for a fledgling industry to overcome early losses and high

costs.¹⁴³ Capital markets, it is argued, fail to invest in these sorts of endeavors because they do not see sufficient future return to justify the early losses. Additionally, making use of foreign direct investment or courting venture capitalists is seen as a worse option than government intervention because such outside investment is not sufficiently concerned with nurturing the fledgling industry.

The assumption being made in this situation is that “non-market institutions deal more adequately with the problems arising from moral hazard than those relying on market-oriented institutions.”¹⁴⁴ Moral hazard, in this instance, is understood as the result of an investor behaving differently when insulated from risk than when fully exposed to it. In the case of investment in a developing economy, moral hazard supposedly arises because market-based investors (capital markets, venture capitalists or foreign direct investment) do not fully internalize the benefits of an investment, but often do fully internalize the risks. Just like the argument in favor of protectionism due to externalities, the argument is that there are additional factors that need to be included in judging whether or not to invest in a new economic endeavor and only the government is far-sighted enough to see such factors. Therefore, the government deals more adequately with the problems arising from moral hazard by seeing a wider range of benefits than market forces would.

This presumption is necessary to say that capital markets are wrong when they won't invest in a particular endeavor, since obviously they are doing their due diligence

¹⁴³ Arvind Panagariya, “Evaluating the Case for Export Subsidies,” 8.

¹⁴⁴ Richard Arnott and Joseph Stiglitz, “The Welfare Economics of Moral Hazard,” *Discussion Paper 635*, Institute of Economic Research at Queens University, Kingston, Ontario, Canada (1986).

in developing a cost-benefit analysis before choosing whether or not to invest. Unfortunately, such a presumption is greatly unwarranted. Especially in the case of developing countries, too often the government is focused on providing benefits to particular groups, regardless of the overall economic costs, and may make poor decisions simply because of patronage or some other poor decision calculus. If capital markets, venture capitalists and foreign direct investment all refuse to invest in a particular economic endeavor there is good reason to believe such investment is a poor decision. Just because the government can rationalize such investment does not indicate it was indeed a good idea. Additionally, defending protectionism on the grounds of externalities or capital market imperfections is notoriously difficult since protectionism must impose an additional market imperfection in order to fix the supposed existing imperfections. Thus, to get straight what manipulations did what and what manipulations would have done what absent additional manipulations is nearly impossible to sort out.¹⁴⁵

So much for capital market failures, but what about the rallying cry that free trade succeeds only in creating massive wealth inequalities? Well, such a claim is not completely unfounded by any means, but it rests on a questionable assumption. First, many who support this argument about inequality refer to the fact that “the ratio of per capita income between the wealthiest 5% of people globally to their poorest 5% counterpart is a stunning 165 to 1.” Additionally they point out that “the top one-tenth of

¹⁴⁵ Rudiger Dornbusch, “The Case for Trade Liberalization in Developing Countries,” 80.

US citizens has a combined income that surpasses the total resources of the bottom two-billion inhabitants of our planet.”¹⁴⁶

These statistics indicate global wealth disparity, but those concerned with development also have their own arguments about inequality. However, such arguments rarely apply simply to free trade, but apply to any sort of development policy. Nonetheless, Trade liberalization may result in an increase in the wage gap between skilled and unskilled workers, thereby increasing overall inequality.¹⁴⁷ But such a gap is justified and not harmful either. Basically, prior to liberalization there were so few skilled workers, and those that were skilled were only moderately so, that whether a worker had a technical education or not she would receive similar pay. Due to liberalization, which brings with it new technical skills, people who gain those skills are rewarded with higher pay. They put in the time to gain the additional knowledge and are justifiably rewarded for it. Certainly it means that the benefits of free trade accrue to such skilled workers to a greater degree than unskilled workers, but again that doesn't appear to be an unjustified result. Far from being unjustified, such a system actually encourages unskilled workers to gain new skills themselves, so they can get paid more as well. Additionally, even if the wage gap widens, if unskilled workers are also getting paid more than they otherwise would the harm of inequality seems meaningless.

Indeed, “philosophers of international justice (and human-rights lawyers) have focused too much on the *distribution* of global resources and not enough on their

¹⁴⁶ Ronald Paul Hill and Justice M. Rapp, “Globalization and Poverty: Oxymoron or New Possibilities?” *Journal of Business Ethics* 85, no. 1 (2009): 39-47. 39.

¹⁴⁷ Fernando R. Tesón, “Trade and Global Justice,” 9.

*production... on the conditions for global economic growth.”*¹⁴⁸ It may not always be true that a rising tide lifts all ships, but in the case of faster economic growth with new industries it is often true. I will return more to the question of fairness in the global economy in the following chapter, but suffice it to say that opposition to better economic performance that benefits everyone, on the grounds that it does not benefit everyone *equally*, succeeds only in maintaining poverty’s grasp on people throughout the globe.

Beyond claims that the market is harmful, protectionists also argue that a successful development scheme requires centralized coordination. Certain industries do better when complimentary industries are present, and thus development works better when a central planner can ensure all complimentary forces are at work. For instance, a computer manufacturer is more likely to succeed when it is certain that manufacturers of mainboards and microprocessors are producing the right amount of their complimentary products. This argument relies, again, on the notion of externalities and the inability of some firms and investors to fully internalize the benefits of engaging a new economic sector.¹⁴⁹ By centralizing the planning of the economy, protectionism can succeed in ensuring every important sector of the economy is developed, regardless of the costs. Such a view is especially prevalent among those in favor of import substitution development, since it relies on a concerted effort at replacing particular imports with domestic production. Such a view falls into a similar trap to the justification based on capital market failures. There is a presumption that the government is better capable of planning and organizing an economy than the market. But all too often the result is the

¹⁴⁸ Ibid., 3-4.

¹⁴⁹ Arvind Panagariya, “Evaluating the Case for Export Subsidies,” 9.

development of inefficient industries or the imposition of harmful economic barriers. Unified development, taken to the extreme as it was in China prior to 1978, has consistently failed. In order to justify its use still within a quasi-market framework requires a lot of work on the part of the protectionist. Unfortunately, such a concerted effort at defending centralized planning within a market economy has not been forthcoming.¹⁵⁰

Additionally, such an argument relies on the government of a country being sufficiently independent and knowledgeable to make the right decisions. And as I will explore in the following sections, such a situation rarely obtains in the developing world. All too often the result of putting the economy in the hands of the government is isolation, corruption, abuse and slow or no economic growth. None of these factors contribute positively to poverty relief efforts, and thus none should be accepted as the basis of a successful economy.

3.2. Protectionism and Corruption

Protectionism can lead to corruption in at least three ways. When a government begins to start handing out economic protections to industry a new wave of special interests and lobbies develop in the political system. Additionally, when a country makes use of quota rents it sets itself up for bureaucratic corruption and patronage. Finally, export subsidies in particular create a massive amount of loss due to corruption. In all three situations, a particular aspect unique to protectionist economic policies can be seen as the mechanism for the corrupt to harm their country.

¹⁵⁰ Nearly all the literature heavily in favor of centralized planning does so from a Marxist, anti-markets perspective and thus falls more in line with full Communism than simply market protectionism.

Let's return to Protectoria to illustrate the link between protectionism, lobbying and poverty reduction. If you'll recall, one of the previous uses of Protectoria had it imposing a 30 percent tariff on imported widgets. This had led to the widgets costing \$1.30 in Protectoria instead of the global market price of \$1.00. The government of Protectoria did this so that it may domestically develop into the widget industry and not get shut out by established foreign competitors. The goal was to have the domestic widget industry develop behind protectionist barriers and then, once it has improved its efficiency enough to become competitive without the barriers, lift those barriers and let the industry fully engage the world widget market. Unfortunately, once the industry had finally developed to be competitive without the barriers it had also become powerful enough to lobby the politicians for permanent protection.¹⁵¹ So, the protection stays in place permanently and the domestic consumers continue to pay more for a product indefinitely.

And this is the fairy tale version of the story. The more likely scenario is all the same lobbying takes place and the barriers remain in place but the industry didn't wait until it had developed to be competitive without the barriers to start lobbying. Instead, it decided it was a pretty sweet deal having a guaranteed market so that it isn't necessary to invest in new technologies or training to improve efficiency. Indeed, the most likely scenario involving trade protections and lobbying is that an inefficient industry holds the citizenry hostage while using its excess profits not to reinvest in the industry to actually

¹⁵¹ Douglas Irwin, *Free Trade Under Fire*, 97.

improve national growth but rather to lobby the government to keep its protections in place.¹⁵²

The above explained how lobbying is used by domestic industries to maintain their own protections. But foreign firms may also lobby government bureaucrats in order to get access to quota licenses. When a country imposes an import quota it is up to the country, particularly some bureaucrats, to pass out the quota licenses. And while a public auction of such quota rights can be a legitimate and fair way of making such decisions, virtually no developing country that has used quotas has auctioned the licenses off. Unfortunately, quota rights are most often handed out arbitrarily and often through illegitimate connections and bribery of corrupt bureaucrats.¹⁵³ And just like “no-bid contracts” in the United States, it is the common citizenry that loses out on such deals, as they are left with lower quality or more expensive products while a few government fat cats reap all the benefits.

Export subsidies fall into many of the same lobbying traps discussed above, but it also brings along with it additional methods of corruption. There are two main ways export subsidies promote corruption: through the additional bureaucracies that are set up to administer the subsidies and through manipulation of the subsidy system so as to earn more than one is allotted. First, the additional costs of export subsidies are rarely taken into account when an analysis is done of the costs and benefits of such subsidies, meaning that often the government is deciding on poor policy due to mistaken

¹⁵² Ibid., 79. Also see Fernando R. Tesón, “Trade and Global Justice,” 4-5.

¹⁵³ Dani Rodrik, “The Rush to Free Trade in the Developing World: Why so Late? Why Now? Will it Last?” 7

arithmetic.¹⁵⁴ But additionally, the need to develop additional bureaucracies and provide funding to these bureaucracies just heightens the risk that national wealth will be held ransom to a few random people's own interests. Indeed, does it seem unlikely that a poor low level customs official wouldn't be willing to take a bribe that may help him feed his family just to let an exporter double count her goods to double her subsidy? Developing countries, especially the least developed, often suffer from bad governance to begin with, but add more remote bureaucracies and the chances of corruption rise.

Indeed, such manipulation of the subsidy system due to corrupt officials is common in the developing world. Due to limited administrative capacity, as well as administrators that are more likely to be corrupt, there is less thorough inspection of goods. This often leads to over-invoicing of exports and the re-exporting of goods in the name of obtaining a greater share of the subsidy money. Latin America suffered greatly from this problem during its protectionist years beginning in the 1970s.¹⁵⁵ In fact, Argentina's experience with export subsidies indicated widespread rent-seeking activities, corruption and systematic countervailing actions by major trading partners. Just one instance of fraud due to subsidy manipulation cost the nation \$100 million!¹⁵⁶

Such losses due to double counts and re-shipping of goods are a real loss to the nation. The government levies a tax either on its people directly or indirectly through import tariffs, pays out the money to domestic firms in hopes of developing the country and improving its citizen's livelihoods and instead is robbed blind. Additionally, when

¹⁵⁴ Arvind Panagariya, "Evaluating the Case for Export Subsidies," 6.

¹⁵⁵ *Ibid.*, 11.

¹⁵⁶ *Ibid.*, 20.

such double count manipulation needs to be substantiated, as it sometimes does, an exporter will physically ship the product twice, resulting in a real resource loss to the nation via unnecessary use of ports and customs.¹⁵⁷ In either situation, those who lose the most are those who had no say in the matter and are already hurting most, the average citizen and especially the most impoverished.

3.3. Protectionism and Conflict

Globalization author Thomas Friedman famously defended the “Golden Arches Theory of Conflict Prevention” which argued that no two countries that both had a McDonald’s ever went to war.¹⁵⁸ His point was to show the benefits globalization can provide for our world in terms of conflict prevention and resolution. And while such a theory sounds arbitrary, the insight is important; economic growth and modernization greatly fight against conflict. And because protectionism sets up barriers to growth, as well as promoting illicit industries, it too contributes to conflict.

Economic protectionism is closely linked to increased illicit drug and smuggling activities. By limiting the scope of the national market protectionism limits the choices available for people wishing to work in the legitimate economy. Thus, in order simply to survive, they must turn to illegal activities, especially drug production.¹⁵⁹ The harms of drug production hardly need illustration. Mexico is currently suffering from major political destabilization which is doing great harm to one of its major economic sectors, tourism. Additionally, people are being extorted, tortured and murdered. Often these

¹⁵⁷ Ibid., 6.

¹⁵⁸ Thomas L. Friedman, *The Lexus and the Olive Tree: Understanding Globalization* (New York: Anchor Books, 2000).

¹⁵⁹ Douglas Irwin, *Free Trade Under Fire* 80-81.

victims are poor citizens just trying to make a living that are caught up in the wrong place. The Taliban of Afghanistan also greatly benefitted from the opium trade when it held power prior to late 2001. Indeed, its attempted resurgence in Afghanistan now is thanks in part to the opium trade. This is not to say these two examples are directly tied to protectionist policies, obviously the drug trade can be a problem in the most open of economies. Nonetheless, ninety-five percent of the global production of hard drugs comes from conflict countries and, as I will detail shortly, protectionism increases the risk of conflict.

Smuggling operations are prevalent in many developing countries, and the more protectionist the country, the greater amount of smuggling that exists.¹⁶⁰ In hopes of avoiding the costs of tariffs or to gain access to a market blocked by import quotas, smugglers often bypass the legitimate economy and even contribute to violence. This is unique to protected economies, since in an economy where a product is freely available smuggling is not cost effective. Indeed, in more open economies the goods that are smuggled in are those that are illegal. But keeping a dangerous item illegal at the cost of dealing with smugglers may be the correct political and economic move. Imposing artificial price hikes on legitimate goods at the cost of creating a smuggling operation where there is no reason for one to exist does not appear to have the same justification.

The increased cost of policing areas for smugglers again make the cost of protectionism higher than is often calculated. Additionally, more resources may be lost and innocent people harmed if things get violent between the smugglers and the

¹⁶⁰ Arvind Panagariya, "Evaluating the Case for Export Subsidies," 6.

government forces. Such violence can create instability, just as the production and ancillary violence of drugs can. The fragile political systems so often found in the developing world may not be able to prevent such low level violence from spiraling out of control into a full blown civil war or coup.

Such risks of civil conflict are heightened in countries that focus their economies on primary commodities. The production and sale of natural resources is often the only industry developing countries can compete in when they are behind protectionist walls. Indeed, in lieu of reducing barriers on intermediate goods so as to gain access to the labor-intensive manufactures and services industries, many of the countries that find themselves deeply in poverty have emphasized production of natural resources. Roughly 29 percent of the people in the economic bottom billion live in societies that are rich in natural resources. However, the “Dutch Disease” is alive and well in these countries. According to the phenomenon known as the “Dutch Disease” nations rich in natural resources will have a difficult time growing economically because resource exports increase the value of a country’s currency on the world market, destroying the rest of their export economy.¹⁶¹ Combine that with the volatile prices of primary commodities and the result is a recipe for economic and political disaster.

Additionally, often the industries producing the primary commodities are either government run or given licensing by the government. As such, corruption has another access point. As a matter of fact, countries dominated by primary commodity exports see elections driven by patronage rather than public service and resource rents behind used as

¹⁶¹ Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*, 38-39.

bargaining chips, if they see elections at all.¹⁶² And all this political corruption cannot help but also increase the risk of civil war and government coups. In fact, dependence on primary commodity exports, especially oil and diamonds, contributes to the risk and duration of civil war. This is because much like the government's bureaucrats who can use resource rents as bargaining chips, rebel leaders will often garner foreign support by striking deals for future resource extraction once the rebels take the government.¹⁶³

Protectionism increases the risk of conflict because it limits economic choices to the point of forcing people into illicit industries or primary commodity exports. But it also contributes to the risk of a coup because it maintains people at low incomes and results in low growth, the two largest risk factors for a coup.¹⁶⁴ Civil War is similarly partially determined by low incomes and low growth. By halving the income of a country its chances of civil war doubles and the lower the average income of a country, the greater its duration of civil war is likely to be.¹⁶⁵

Of course this situation makes sense. When there are few economic opportunities available and things appear mostly hopeless, joining up with a militia or rebel group doesn't sound like a bad option. Often they offer, as many of the fundamentalist religious groups do, the basic necessities to survive. All they ask in return is obedience to a dangerous cause. Again, by limiting options protectionism succeeds only in pushing more of a country's population towards illicit and violent occupations that will constantly militate against sustained economic growth and good governance. Such conflict, like

¹⁶² Ibid., 41-47.

¹⁶³ Ibid., 21-22 and 26-27.

¹⁶⁴ Ibid., 36.

¹⁶⁵ Ibid., 19-20 and 26.

trade itself, doesn't only impact the country in which it is happening. Indeed, disease and economic collapse due to conflict spread to neighboring countries and regions, which are often poor and suffering as well. The effects of conflict are most certainly exponential, as the collapse of one country may start a domino effect in the region.¹⁶⁶

Adam Smith is quoted as saying in a 1755 manuscript:

Little else is required to carry a state to the highest degree of affluence from the lowest barbarism but peace, easy taxes, and a tolerable administration of justice; all the rest being brought about by the natural course of things. All governments which thwart the natural course are unnatural, and to support themselves, are obliged to be oppressive and tyrannical.¹⁶⁷

Peace is exactly what protectionism protects against by providing openings for the misallocation of a nation's resources and wealth as well as increasing the risk of conflict. The goal of development is, simply put, "to carry a state to the highest degree of affluence" and if Smith is right that peace is a necessary condition of such affluence, then protectionism is certainly an illegitimate development policy.

3.4. Free Trade, Bad Governance and Poverty Reduction

Free trade counters the harms of bad governance in two main ways: it actually makes political reforms more likely and is closely linked with improvements in social services. In both cases, free trade and the economic growth that accompanies it fights against both the "bad governance" and "conflict" traps that partially explain why the situation is so grave for the poorest billion people in the world.

¹⁶⁶ Ibid., 31.

¹⁶⁷ Dugald Stewart, "Account of the Life and Writings of Adam Smith LL.D.," *Transactions of the Royal Society of Edinburgh*(January 21, 1793).

Free trade leads to political reforms in a few ways. Directly, it reduces government and corporate power and therefore reduces overall corruption and mistreatment of the average citizen. Indirectly the growth that free trade creates leads to increases in income which reduces the overall risk of conflict as well as establishing a large middle class, which is vital to successful democracy. Indeed, as one commentator explains: “Without growth peace is considerably more difficult. And in the societies of the bottom billion the economy is stuck.”¹⁶⁸ Getting the economy moving in a positive direction is vital to social and political reforms, and trade liberalization is a vital component of getting the economy moving in that positive direction.

By taking away many of the mechanisms by which government officials can succeed in being corrupt, including the selling of quota rents and subsidies, free trade immediately makes an impact on the governance of a country. When firms have to compete, domestically and internationally, they are forced to invest excess profits into productivity gains rather than political lobbying. When firms do not have the government’s ear, they must fend for themselves in the arena of the market, and in that arena failure to be efficient means your firm will fail. Such a situation necessarily lessens the power of both the government bureaucrats and the firms, but actually increases the power of the average citizen. Now the consumer can demand a price and the firms will have to meet it or fail; now the citizen can demand government accountability and the government will have to give in because their illegal profits no longer exist. In both

¹⁶⁸ Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*, 37.

situations, government gets closer to truly being for the people, but certainly trade is not able to create drastic reforms all by itself.

Beyond the direct removal of the means of corruption and abuse, the greater benefit of trade liberalization comes from the economic growth it provides. In discussing the risk that any of the least developed (bottom billion) countries will fall back into civil war, Paul Collier's research indicates that within any five year period the risk is one in six. However, economic growth and income gains both directly decrease that risk. Additionally, growth leads to export diversification, especially away from primary commodities. And as discussed above, economies reliant on primary commodities are even more likely to fall into traps of conflict and bad governance.¹⁶⁹ Indeed, economic growth in itself succeeds in easing tensions within a country and thus decreasing the risk of conflict. But even more important is that income gains resulting from economic growth pull people out of poverty and possibly into the middle class.

A large middle class is often considered a prerequisite to successful democracy. The idea is that poor people lack the ability to have a political voice due to spending much more of their time and income just trying to survive. People in the middle class, however, begin to find luxury time to keep up on political issues, educate themselves on those issues, and actually work towards making a difference. That is why open trade often leads to less corruption and more accountable governance; the people demand such things once they have the power to do so.¹⁷⁰ In fact, the globalization that occurred in the

¹⁶⁹ Ibid., 32.

¹⁷⁰ Douglas Irwin, *Free Trade Under Fire*, 57.

late nineteenth-century is closely linked to the initiation of the “first wave” of democratization.¹⁷¹

Such a claim is backed up my empirical studies as well. One study looked at what conditions were most likely to lead to government reform and what conditions were most likely to allow such reforms to be successful and sustained. Both situations shared two factors: population size and education.¹⁷² In the case of the possibility of reform, these were the two largest factors and free trade contributes to both in multiple ways. Trade liberalization and economic growth reduces infant mortality and early mortality in general by improving living conditions. Additionally, economic growth leads to people being better able to access education and can often lead to greater government investment in education. These two factors were so important, in fact, that near the bottom of the list of important factors is where one could find democracy and political rights. This indicates that strong economic performance is in fact often a prerequisite to democracy and political liberties, not the other way around.

Whether a country’s policy reforms are successful and sustained depends not just on population size and education, but also on income levels. The higher a country’s per capita income, the more likely policy reforms are to be successful and stay in place. Again, trade liberalization is in a better position to raise a country’s per capita income and thus in a better position to initiate political reforms. The same study found that a favorable shift in the terms of trade, as would occur when a country adopts a policy of

¹⁷¹ Ibid., 56.

¹⁷² Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*, 70-72.

import substitution, actually has a *negative* influence on sustained political reform.¹⁷³ This indicates, again, that political reforms are likely to result from economic success, not the other way around, and that trade liberalization gives the best hope of such reforms.

Once the government has been reformed to be sufficiently responsive to its citizen's needs, or if it is already at that point, trade liberalization also promotes good governance through the improvement of social services. Empirically, trade has reduced energy depletion and increased access to clean water, better health care, better education and better technologies to improve the environment.¹⁷⁴ Such benefits come about in a few ways. First, since economic growth often leads to political reforms, trade liberalization leads to better social services simply by making the government more responsive to its citizen's needs.

Trade liberalization also succeeds in improving social services because it actually puts more money into the government's hands, thereby increasing the amount of money the government has to institute and fund social programs. Interestingly, protectionists often point to government revenue as a reason to oppose trade liberalization. In some of the poorest countries in the world, trade taxes can make up between one quarter and one half of central government income.¹⁷⁵ If this is the case then removing such revenue will greatly reduce the amount of money a government has to provide social services. This is untrue in most cases, however, as the elimination of quotas actually returns money previously being lost to quota rents to the government. Additionally, by reducing the

¹⁷³ Ibid., 71-72.

¹⁷⁴ Douglas Irwin, *Free Trade Under Fire*, 60-61 and 68.

¹⁷⁵ Dani Rodrik, "The Rush to Free Trade in the Developing World: Why so Late? Why Now? Will it Last?" 27.

impetus for smuggling and drug production the government reduces the need to fund high levels of policing regarding these illicit activities. After 1983, when Ghana began to liberalize trade, it benefitted from this very phenomenon. It made legitimate imports cost competitive with smuggled goods, thereby weeding out smuggling operations.¹⁷⁶

The social and political benefits of trade liberalization should not be discounted. Certainly open economies grow faster, certainly faster growth results in higher incomes and a reduction in poverty. But by also driving social and political reforms within a country, economic liberalization succeeds in empowering people, all people, to live their lives as they see fit with their basic needs met. Such empowerment is exactly what the poorest billion people in the world need, as their countries are stuck in at least one of two traps: bad governance or conflict.

I have discussed the bad governance and conflict traps in the previous two sections, but want to emphasize now the impact such traps have on poverty. Conditions for the bottom billion are markedly worse than those living in other developing countries. Life expectancy averages fifty years, as opposed to sixty-seven in other developing countries. Infant mortality averages 14 percent, compared with four percent in other developing countries. Finally, the percentage of children with symptoms of long-term malnutrition is 36 percent, a full 16 percent higher than other developing countries.¹⁷⁷ Once bad government settles in a poor country, or the country goes through a coup or civil war, it is all the more likely to continue to see bad governance and continual

¹⁷⁶ Ibid., 27-28.

¹⁷⁷ Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*, 7-8.

conflict. In such a situation it is impossible to reduce poverty. Reforms by one government are overturned by another after a coup or war; war itself costs a country an exorbitant amount of money. The cost of a typical civil war to the country and its neighbors (remember, wars spillover) is estimated at around \$64 billion. Even worse, in recent decades about two new civil wars have started each year, so the global cost has been well over \$100 billion a year, which is around the global aid budget.¹⁷⁸

Bad governance and conflicts are likely to lead to poor economic performance, and poor economic performance is likely to lead to bad governance and conflict. It would appear the countries in such a position now are indeed trapped. And while trade liberalization cannot solve all the problems on its own, it certainly makes such reforms more likely. On top of initiating economic growth and real income gains, trade liberalization contributes to export diversification. This is especially important in conflict areas, where primary commodities often drive their current economic performance and is a big reason they remain stagnant. Being able to move into other, more stable sectors such as manufacturing and services will aid these countries in reducing the financial benefits of coups and civil wars for those not in power, as well as reducing the ability for government officials to be corrupt. All those in the anti-Globalization movement concerned with human rights and peace, as many of them claim to be, would do well to recognize the invaluable contribution economic growth, driven by trade liberalization, makes to peace and individual liberty.

¹⁷⁸ Ibid., 32.

4. Conclusion

My focus in this chapter has been on comparing the benefits of free trade to the harms of protectionism for short term and long term economic performance as well as social and political issues. In all cases it is the most impoverished who benefit from a free trade regime and lose out from a protectionist regime. In the short term protectionism both reduces national wealth as well as transfers existing wealth from the consumer, often impoverished, to producers. The anti-Globalization movement often rallies behind the claim that corporations are evil and opposed to individual's rights, but protectionism in fact succeeds only in empowering such corporations to do their harms with impunity. Both through the transfer and loss of national wealth, efforts at poverty reduction are greatly hampered.

In the long run, which is where most protectionists stake their claim, closed economies actually grow less and are unable to sustain such growth. Sustained growth is a critical component of long term poverty reduction and ensuring backslides do not occur. Because protectionism militates against productivity gains and export performance, it is unable to put a country in a position to succeed on a sustained basis.

Finally, trade liberalization doesn't just contribute to economic growth, it also contributes to social and political reforms. Far from leading to corporate fascism or the abuse of workers at the hands of multi-national corporations, free trade reduces government corruption and forces companies to compete for access, meaning those that truly are abusive often lose out. Additionally, many of the least developed countries in the world suffer from poor social services, especially healthcare and education. Both of these services are vital to individuals raising themselves out of poverty and thus by

putting more money into the hands of a more transparent government trade liberalization succeeds in providing the means to subsistence for a great deal of the global poor.

It is indeed true that trade liberalization does not succeed in any of the above ways and thus reduce or eradicate poverty all on its own. Infrastructure and macro-economic stability are vital to the successes of trade liberalization. But even trade liberalization is conducive to gains in infrastructure, by providing more money to the government, and macro-economic stability by providing real wealth creation and stable governance. Thus, trade liberalization is more conducive to poverty reduction than protectionism.

CHAPTER 3: GLOBAL ECONOMIC FAIRNESS

In the previous chapters I have mostly neglected concerns of fairness in the global economy, instead focusing directly on the more tangible harms of protectionism and benefits of free trade. In this chapter I aim to respond to criticisms of free trade based on fairness concerns. Such concerns appear to dominate the philosophical literature and indeed most philosophers that oppose free trade do so not on practical grounds but on theoretical grounds, namely due to it being “unfair” in one way or another.

While multiple theories of fairness in the global economy have been developed, section one will aim to provide a strong case for what I see as the most plausible theory of fairness in the global economy. I will then apply such a theory to three different cases of “unfairness” in the global economy. Section two will examine worker exploitation, namely through so-called “sweatshop labor”. Section three will attempt to reconcile the fact that much of the developed world is not fully liberalized while they continue to call on the developing world to do so. Finally, section four will examine “Fair Trade” and its role in development and poverty reduction.

1. Theory of Fairness in the Global Economy

Theories of fairness for the global economy can take on many different forms, depending on the underlying theory of when fairness applies and to what it applies. Whether it applies simply between nation-states, such that fairness is not an issue between individuals of different countries, or if individuals are the basic unit of moral

concern will greatly alter the theory. Additionally, fairness can apply in terms of the move from a closed economy (autarky) to an open economy or it can apply within the structure of an already assumed open economy. Depending on the view taken in this regard different notions of fairness will arise. Finally, whether principles external to the current structure of the economy apply in determining if the global economy is fair or not will create drastically different principles of fairness.

To make the strongest case possible for fairness in the global economy, I will analyze the different conceptions of harm that may apply to the global economy. I will then analyze the difference between internal and external principles and make a case for the application of only internal principles to the global economy. Finally, with the work done on what sort of conception of harm and what sort of principles should apply to the theory of fairness I will sketch a theory of fairness for the global economy around the notion of “structural equity”.

1.1. Diachronic and Subjunctive Harm

In the previous chapters I have often justified shifts to liberalized trade on the grounds that they make the people better off than they were without such liberalization. Such a conception of harm is often employed by economists to justify their economic theories and policies. But such a conception of harm, call it the diachronic conception, is not the only option available to us. Thomas Pogge, in his work on a theory of fairness in the global economy, makes a distinction between the diachronic view favored by most

economists and what he calls a “subjunctive” conception of harm.¹⁷⁹ For Pogge, it is not good enough to say someone has been made better off than they previously were. For example, we would still tend to agree that a slave, so long as he is a slave, is being harmed, even if he has gone from being whipped five times a week to only two.¹⁸⁰ The diachronic conception of harm, however, dissuades us from saying such a person is still being harmed. Thus, Pogge seeks to justify his subjunctive conception.

A subjunctive conception of harm allows Pogge to say that “an institutional arrangement can harm a group even if the transition to this arrangement diachronically benefits this group.”¹⁸¹ According to this view of harm, a subjunctive baseline is set based on the sort of particular harms in question, and the determination of whether an institutional arrangement is harmful or not is based on whether or not it exceeds the baseline, regardless of where the previous institutional arrangement was in regards to the baseline and the new arrangement.¹⁸² Thus, instead of saying a new institutional arrangement strictly benefitted a group because it led to less harm than the previous arrangement, if both arrangements fail to meet the baseline they are both harmful.

Such a conception necessarily leads us to ask what sort of baseline should be set for determining harm in the global economy. It seems as though many different baselines could be given by people concerned with different components of the global economy. On top of the position offered by Pogge, Nicole Hassoun has also offered her own view

¹⁷⁹ Thomas Pogge, *World Poverty and Human Rights*. 18-26.

¹⁸⁰ *Ibid.*, 18-19.

¹⁸¹ *Ibid.*, 23.

¹⁸² *Ibid.*, 23-24.

on what should count as the subjunctive baseline.¹⁸³ I will consider each view in turn. Pogge's subjunctive baseline is based on what he considers the common view people would have when faced with a situation such as determining if slaves in better conditions are still harmed or not. Most people would say they are still harmed, even if less so, because the institutional order imposed on them "avoidably denied them freedom of movement, free choice of occupation, freedom from assault, rape, and torture, access to basic education, health care, and political participation."¹⁸⁴ Based on this view, Pogge draws a baseline and concludes that "[an] institutional order harms people when its design can be shown to be unjust by reference to a feasible alternative design."¹⁸⁵ Thus, harm is not a matter of comparisons merely to past institutional orders but by comparison to all possible feasible alternatives as well.

To make this stance clearer, Pogge asserts that it is possible to deem an institutional order unjust when it predictably produces an avoidable human rights deficit. Thus, if in determining particular policies within the global economic order a legitimate case is made for a particular policy producing a human rights deficit that a feasible alternative policy would not produce and yet the policy with the deficit is instituted it is unjust and harmful. Pogge resorts to "human rights deficits" because he sees it as the "internationally recognized minimal standard of our age."¹⁸⁶ Human rights for him, however, are not interactional, but institutional. They are first and foremost "claims on coercive social institutions and secondarily as claims against those who uphold such

¹⁸³ Nicole Hassoun, "World Poverty and Individual Freedom," *American Philosophical Quarterly*, 45, no. 2 (April 2008).

¹⁸⁴ Thomas Pogge, *World Poverty and Human Rights*, 25.

¹⁸⁵ *Ibid.*

¹⁸⁶ *Ibid.*

institutions.”¹⁸⁷ In order to “de-Westernize” human rights, Pogge also adds that viewing human rights in such a way does not necessitate a legal-rights culture whereby each human right is codified in society by matching individual legal rights. Thus societies need only ensure certain basic needs are met, in whatever way works for that society, instead of establishing a constitution that codified each independent right in its legal system.¹⁸⁸

The upshot of this view of harm and its relation to institutional orders is that in examining the empirical evidence of the global economic order’s influence on global poverty the focus should be on whether certain basic needs, generally conceived as basic human rights, are being violated in an avoidable way, regardless of if the previous global economic order violated them worse. The problem with such a view, however, is that not all human rights are influenced by the global economic order. A person may have absolute economic freedom and access to all necessary economic goods yet still have her human rights violated if she is unable to, for instance, speak out against her government. Thus Pogge’s subjunctive baseline may indeed be too wide ranging to be justifiably applied solely to the “global institutional order” as he attempts to do.

Hassoun’s subjunctive baseline may provide a better measure for the global economy in itself. In responding to those who are skeptical of an obligation to alleviate world poverty, she makes use of the skeptic’s basic assumption that individual freedom prevents us from having such wide-ranging positive duties to argue for such a duty. In her view, and one shared by many other commentators on development and poverty reduction including Amartya Sen, the most basic harm of poverty is its denial of

¹⁸⁷ Ibid., 50-51.

¹⁸⁸ Ibid., 51-53.

autonomy.¹⁸⁹ It is, at it were, *because* we all have a right to live autonomously that we *in fact* have an obligation to alleviate (or more properly, eradicate) world poverty. As she explains it, for any coercive global institutional system to be considered even *minimally* legitimate as many of those living under the system must be able to autonomously agree to live under it. However, since it is quite impossible to determine which individuals will be capable of autonomously agreeing to live under such a system, the coercive global institutional order must enable every individual to do so. Thus, a coercive global institutional order must allow all individuals to meet their basic needs, as this is what Hassoun views as the basis of autonomy.

An additional claim that must be defended for Hassoun's view is that the global economy is indeed a coercive institutional system. Her argument for this is quite simple. The global economy is defined, at least in part, by a multilateral trade system headed by the World Trade Organization. The WTO has been charged with implementing and enforcing trade policy and has the power to punish nation-states who violate its dictates. As such, the global economy is a coercive institutional system. It is clearly an institutional system under the dictates of the WTO (along with other organizations and governments) and it is most certainly coercive as it is capable of requiring nation-states to follow its dictates.¹⁹⁰ Such a view is shared by Thomas Pogge, and I believe it to be a relatively uncontroversial claim to label the global economic system a coercive

¹⁸⁹ Nicole Hassoun, "World Poverty and Individual Freedom," 191. Also see Amartya Sen, *Development as Freedom* (Oxford: Oxford University Press), 1999.

¹⁹⁰ *Ibid.*, 192. Also see: Nicole Hassoun, "Freedom and Autonomy," *Carnegie Mellon University Working Paper*. Available at <http://www.hss.cmu.edu/philosophy/faculty-hassoun.php>.

institutional system.¹⁹¹ I will conclude, then, with what Hassoun believes to be the “basic needs” that must be met for the global economic system to be considered (minimally) legitimate.

According to Hassoun:

In fact, for most people to do much of anything other than think about the state of their stomach, they must be fed. In order to do much, besides worry about survival, most people must have shelter and bodily integrity. The radically poor are likely to lack such things. They are likely to suffer from disabilities like frequent sickness and malnutrition. These disabilities can prevent normal development and clear reasoning and thus function as road blocks to autonomy.¹⁹²

Autonomy, then, is inextricably linked with poverty and its associated harms. Thus, on her conception of the subjunctive baseline, it can be said that an individual is being harmed so long as she is in poverty. Additionally, basic subsistence needs such as shelter and access to sufficient nutrition may not be met even if a person is not, on some account or another, in poverty. Thus, while it is sufficient in most cases to simply use poverty as the baseline it may, in certain situations, be necessary to examine the component harms of poverty in themselves as well.

The analysis of harms, thus far, has provided the following conclusions: while a diachronic conception of harm may be applicable in certain situations, the global economy, based on the fact that it is a coercive global institutional arrangement and thus quite pervasive, appears to demand a subjunctive conception of harm when determining its legitimacy and the pervasiveness of its harms. The baseline for this subjunctive

¹⁹¹ Thomas Pogge, *World Poverty and Human Rights*, 30. Additionally, nothing of major importance seems to rely on this label. Even if the global economic system is not coercive the same argument can effectively be made that it should enable all participants to meet their basic needs.

¹⁹² Nicole Hassoun, “World Poverty and Individual Freedom,” 195.

conception of harm can be viewed as inextricably linked to poverty, such that an inability to meet one's basic subsistence needs indicates that one is being harmed. The baseline can also be viewed as the fulfillment of basic human rights, as Pogge argues. In what follows I will argue that while a subjunctive conception of harm may be justified in application to the global economy, neither Pogge nor Hassoun's subjunctive baseline should be used in examining fairness in the global economy.

3.2. Internal and External Principles

Pogge's argument for the subjunctive baseline of "human rights" for determining if someone is harmed by the global economic system is too broad because it invokes principles that are wholly "external" to the structure of the global economic system (and likely external to any global economic system). When establishing a theory of fairness for a particular system, in this case the global economic system, there are two fundamentally different ways to establish the principles for the system. External principles, such as Pogge's, are justified and apply independently of what the global economic and its social organization actually is like. Internal principles, on the other hand, have the "shape and content" they have because the global economy is socially organized in a particular way.¹⁹³ Put another way, many principles of justice, such as some conceptions of distributive justice, may make passing reference to the global economy and may even require a global institutional scheme for their implementation. But such principles do *not*

¹⁹³ Aaron James, "Global Economic Fairness: Internal Principles," in *Global Justice and International Economic Law: Opportunities and Challenges* (Cambridge: Cambridge University Press), forthcoming, 1-2.

require a particular (or this particular) global economic system for their very applicability. They would apply regardless of the scheme in place.¹⁹⁴

Hassoun's conception of harm in the global economy as the existence of poverty is also external to the global economic order, as the elimination of poverty is a principle that would exist regardless of the structure of the global economic order.¹⁹⁵ To view the fairness principles of the global economic order as external is problematic in a practical way. Effectively, external principles often, although not always, critique the existence of the system, rather than attempting to understand the goals of the system and establishing principles of fairness from within the constraints of those goals. While there may be good theoretical reasons to develop such ideal theories, if the concern is with practical fairness then principles of fairness for the global economy ought to be internal to the system. As such, the principles should not call into question the existent system but rather argue for what rules, within the given system, ought to be adopted to make the system fair.

Often those individuals concerned with fairness as an external matter see the only alternative as the inapplicability of fairness to the global economic order because there is no single organizing unit from which fairness can emanate.¹⁹⁶ However, internal principles find a middle ground by arguing that while it may be true that there is no single organizing unit the fact that the global economic order is a social practice of mutual market reliance with particular goals does give rise to particular fairness concerns. Namely, fairness can be applied to the particular goal of the system, which is mutual gain

¹⁹⁴ Ibid., 2.

¹⁹⁵ Ibid., 4.

¹⁹⁶ Aaron James, "Skepticism about Fair Trade," *UC-Irvine Working Paper*, February 2006. Access <https://webfiles.uci.edu/ajames/Ch%203%20Economic%20Skepticism.doc> .

through greater efficiency via the division of labor, establishment of economies of scale and the spread of technologies and ideas.¹⁹⁷ There are better and worse ways to achieve this mutual gain, and since this gain is supposed to be mutual the concern can be raised that perhaps some countries or individuals are actually losing out while others gain.

Internal principles should be the basis of any theory of global economic fairness. Internal principles should be adopted because the difference between external and internal principles maps the difference between ideal and non-ideal theory. External principles are generally part of an ideal theory of justice, such as cosmopolitanism. Such a theory is the best possible arrangement humanity could establish, and may be useful as a benchmark for comparing the arrangement we have, but it doesn't necessarily tell us how to reform what arrangement we have to make it more fair. It may in fact require that we scrap the entire endeavor and start over, a command that is quite useless if our concern is truly with fairness in our existent world.

Non-ideal theory, on the other hand, does not take for granted that the current arrangement is unlikely to be completely dislodged. Instead, non-ideal theory takes certain aspects of the arrangement as given and seeks to create a theory from within those particular constraints. Internal principles of fairness, then, function within a non-ideal theory of fairness (or justice) to indicate what rules or terms should be adopted for the global economic system to be considered fair within what it was designed to do. This rules out holding the global economic system accountable for political freedoms, for instance, and also removes concerns associated with certain countries simply having

¹⁹⁷ Aaron James, "Global Economic Fairness: Internal Principles," 10.

better natural endowments such as more arable land or greater access to natural resources. Such inequality of natural endowments exists independent of any economic structure or the existence of any economic structure at all. As such, it is unjustified to require any global economic system to compensate for such inequalities.

Internal principles also take into account the basic unit of moral concern within the global economy. While ideal theories will seek to alter the basic unit in the institution, non-ideal theories must take the basic unit as given. In the case of the global economy, ideal theories such as cosmopolitanism seek to label individual people as the basic units of concern. However, the international trade regime is based on increasing *national* wealth, not individual wealth. Within a particular society issues of distributive justice may arise concerning the individual, but in the global economic system nation-states are the basic units of concern.¹⁹⁸ Thus, non-ideal theory allows us to both urge a shift towards individuals as the basic unit of concern externally based on ideal theory while internally attempting to argue for fairness within the regime that currently exists.

Finally, internal principles are less likely to come under major criticism or scrutiny, if developed clearly. So long as a critic agrees to the underlying goal of the structure in question the internal principles should necessarily follow. So while there may be disagreement on exactly what the underlying goal of the global economic system is, which could lead to different internal principles, so long as that goal is well established what follows should be of little disagreement. Thus far, then, I have established that harm in the global economy should be viewed in some sort of subjunctive concept while

¹⁹⁸ Ibid., 18.

rejecting the two subjunctive concepts offered by other philosophers. This is because whatever subjunctive concept is used must be wholly internal to the structure of the global economy if it is to be of value for real economic justice, and not merely ideal theory. In what follows I will sketch what I believe to be the most plausible view of economic fairness on internal grounds.

1.3. Global Economic Fairness as Structural Equity

The economics literature tends to be skeptical of the applicability of fairness to the global economy due to two implicit assumptions. The first is that questions of fair reciprocity in access do not apply because the removal of trade barriers is not burdensome to the country removing the barriers. Put simply, if removing barriers to trade does not produce a negative cost (or more particularly, only produces benefits) then a country removing its trade barriers has no claim on other countries to do the same. The second assumption is that this notion of fair reciprocity is the only notion of fairness that could apply to the global economy.¹⁹⁹ So, if fair reciprocity is the only sort of fairness that could apply to the global economy, but it doesn't apply because the requisite justification for claims of reciprocity is lacking then fairness doesn't apply to the global economy.

Such a view fails to take into account the actual aim of the global economic order and why countries integrate into it. Aaron James argues that fairness can apply to trade (and the global economic order more generally) if three assumptions about the system are true. First, it is assumed that there exists a multilateral practice of mutual reliance on

¹⁹⁹ Aaron James, "Skepticism about Fair Trade," 4.

global markets. Second, the structure of this multilateral practice has alterable consequences both within and across societies. Finally, the consequences of the practice determine whether it is fair to those involved.²⁰⁰ I will examine each assumption in turn.

To claim that a multilateral practice of mutual reliance on global markets exists is to claim first that global markets exist. So much is true, as goods, services and finances migrate across borders regularly. Second, the multilateral practice of mutual reliance entails two interacting components: both a multilateral structure and a common understanding that the markets will function in such a way as that they can be relied upon to maintain some level of economic stability. The multilateral structure is easy to identify if the World Trade Organization is taken as the unifying body of such a structure. So, while multiple countries may sign bilateral or regional trade agreements with each other, there is this one unifying body that attempts to have all of its members (153 nation-states and economically autonomous territories) follow at least some basic rules of economic engagement. It can be said, then, that the WTO represents the multilateral structure that its members mutually rely on. The final issue, then, is what this mutual reliance looks like. First, there is the assumption that the WTO will in fact enforce its dictates, such that if a country disputes a particular trade barrier as in violation to the WTO by-laws the WTO's dispute resolution system will indeed side against the offending party, if it is indeed offending against a WTO requirement. Additionally, there is reliance upon the global markets to continue to deliver the necessary goods so that a particular country's

²⁰⁰ Ibid., 1.

economy will, at least, be supplied with what it needs externally. Thus, it is justified to assume that trade is a multilateral practice of mutual reliance on global markets.

To assume that the structure of this multilateral practice has alterable consequences both within and across societies is quite uncontroversial. Whether the World Trade Organization requires and enforces labor or environmental standards, for instance, will alter the results of engagement in the global market system both within societies, as it will define internal labor and environmental protections, and across societies, as it could possibly balance the playing field in terms of labor and environmental laws. Additionally, whether the World Trade Organization promotes a purely egalitarian policy or special treatment for developing countries will alter the consequences of the global markets. Furthermore, the WTO provides a schema for the gradual reduction of trade barriers but it does so with different categories of countries so that not every country is reducing at the same rate or to the same levels. Were this structure to be different, consequences would be quite different as well. Thus, it is quite justified to assume that the structure of the practice of mutual market reliance has alterable consequences both within and across societies.

The final assumption, then, is that fairness is determined by the consequences of the practice. While this assumption may be questionable in philosophical circles, as it effectively takes for granted some form of consequentialism as the basis of fairness, it is less questionable among economists. Generally speaking, economists use some sort of utilitarian theory to justify policy prescriptions. Such a theory will seek to create a state of affairs (the consequences of the act) that maximizes utility. While they may cash out utility in different ways, the point is they all implicitly accept that consequences are all

that matter. Additionally, if we are discussing policy prescriptions it is quite hard to make use of any other ethical theory as it is difficult to assign intentions to a collective action and as a collective action notions of virtue would be hard pressed to fully apply. Nevertheless, the assumption may be criticized as unsatisfactory by philosophers and others but it is supposed to be a descriptive assumption to encourage economists to see that issues of fairness do apply to the global economy. As such, the assumption can be accepted as sufficient for this purpose.

Now that the three assumptions underlying a theory of fairness in the global economy have been defended, it is possible to explain what sort of theory of fairness applies to the global economy. Based on the analysis above regarding subjunctive harms and internal principles, it is clear that whatever theory is accepted must fit both those criteria. To be internal, the theory must not call into question the global economy as such, but rather explicate how its rules could be altered to produce different consequences and determine fairness based on whether the actual arrangements are equivalent to or better than the alternatives. James's theory of "structural equity" does just this.

If the primary goal of the global trading system is to improve the variety, number or quality of general goods or services that societies would enjoy even in economic isolation, which it appears to be, then principles of fairness must be constrained by such a goal.²⁰¹ This means that strongly egalitarian principles can't apply, since they would necessitate giving all participants in the global economy access to all the same goods, even if they would not have access to those goods in a closed economy. Mutual reliance

²⁰¹ Ibid., 20.

on the market system is aimed at mutual gain, but that does not imply everyone gets exactly the same amount of all things. It means something more akin to country A getting more of goods set x (more meaning either in quantity, quality or variety) that it already had access to before engaging in the practice of mutual reliance on the markets. It does not (necessarily) mean country A gets access to goods set y that it previously had no access to, although trade may allow such an arrangement to arise.

From within these constraints James develops three basic principles of what he calls structural equity.²⁰² Generally speaking, structural equity implies that a system must be structured (rule-governed) in such a way that it provides an equitable distribution of both burdens and benefits. The first principle says that there must be fair distribution of the harms of trade, such that no person's life prospects are to be worse than they would have been absent entry into the market system. This is both a demand placed on nation-states as they negotiate, such that no nation-state is forced to enter the system on terms that make it worse off, and also a demand placed on the government within a nation-state such that they do not make their citizens worse off by integrating into the global economy.

The second principle focuses on the equal distribution of the gains of trade within societies. According to this principle inequality is only justified if it is acceptable to all members of the society. While this demand generally won't apply to all members of the global economy, but only those with distribution issues, it does imply certain basic obligations for all members of the global economy. If all countries that participate in, or

²⁰² Aaron James, "Global Economic Fairness: Internal Principles," 12.

are affected by, the global market system are to benefit from the system, which is the overall requirement of structural equity, then all participants in the system bear the responsibility of establishing the infrastructure necessary to make such possibilities of benefit a reality.²⁰³ This includes, for instance, aiding in the creation of compensatory institutions that help offset the harms of trade for particular members of society, such as those who lose their job due to their industry no longer being able to compete. Since some nation-states, especially the least developed, may be unable to build such institutions themselves but their engagement in the global economy necessitates mutual gains a duty can be imposed on other members of the system to work towards creating such institutions.

The final principle also focuses on the equal distribution of the gains of trade, but emphasizes the equal distribution across societies, such that unequal gains are only justified if they flow to poor countries or are justified based on relevant endowment differences, such as a greater population in one country than another. The key addition to all three of these principles, however, is that they apply to the overall long-term structure of the economic system, not to any particular economic transactions.²⁰⁴ As such, a particular transaction may provide greater benefits to one country or set of countries over another in what may be considered an unfair way, but so long as the overall structure is still fair, there is not a fairness concern. For instance, the WTO recommends preferential treatment for developing countries as a matter of structural equity (it is codified in the WTO by-laws) but in particular trade agreements a developed country may come out

²⁰³ Aaron James, "Skepticism about Fair Trade," 17.

²⁰⁴ Aaron James, "Skepticism about Fair Trade," 7.

better than a developing country, but since engagement in the overall structure returns fair benefits over time, it is not the case that the particular agreement is unfair in terms of structural equity, although some other theory of fairness may apply.

These principles, taken together, imply the basic responsibility of all countries engaged in the practice of mutual market reliance to make a “good faith effort to apply given rules in the light of both their understood purpose and the principles that specify a structurally equitable trading practice.”²⁰⁵ Additionally, these principles oppose the cosmopolitan theory of justice promulgated by philosophers such as Thomas Pogge. While the second principle indicates that a country has a duty to ensure the benefits of trade are distributed fairly to the citizens within its borders, the third principle is not concerned with fair distribution among individuals throughout the world but rather fair distribution among nation-states, since the structure of trade as it is concerns itself with gains to national wealth not to individual wealth. Finally, such a view does not necessarily call into question the fairness of free trade, as external theories may. Instead, so long as the structure of free trade is such that the distribution of advantages and disadvantages are equitable it can be considered fair.

This theory of fairness in trade fits both of the requirements set forth above. The principles are internal (and thus the theory can be said to be internal) insofar as they do not call into question the schema but simply make use of its stated goals to establish their justification. Additionally, it makes use of a subjunctive view of harm insofar as it doesn't simply require that a country or individual is made *better* off, but argues that

²⁰⁵ Aaron James, “Global Economic Fairness: Internal Principles,” 19.

harm may still occur so long as the distribution is not equitable. A final important component to James's theory of structural equity, however, is how it deals with short term losses for the sake of long term gains. James is quick to point out that free trade can often result in some industries becoming no longer competitive and the workers, therefore, losing their jobs. Such losses, however, are irrelevant to the third principle since it concerns national gains. But such losses do apply to the second principle, concerning the distribution of gains within societies, but simply asks for compensation to those who may lose their jobs due to the liberalization of markets. As discussed above, this may place a duty on the other members of the global economy to help establish such compensatory institutions, but the obligation first and foremost falls on the country. Its government is making the conscious choice to join the global economy to improve its national wealth with full recognition that doing so may shift the focus of the economy. Thus, while the individuals within the country have a legitimate claim on the government to be compensated, they do not have such a legitimate claim on other countries, except insofar as the country as a whole has a claim to receive fair benefits from joining the global economy.

The theory of structural equity, and its constituent principles, then, offers us a subjunctive, internal theory of fairness for the global economy that is likely to provide policy prescriptions that could be adopted from within the system as it is, rather than requiring the overturning of the entire system. In what follows in this chapter I will seek to apply such a theory to three different fairness issues in the global economy: worker exploitation, protectionism in the developed world and "Fair Trade".

2. Worker Exploitation

Worker exploitation in the developing world has come to dominate the anti-globalization and anti-free trade movements. There are constantly protests of stores selling clothing and other goods made at so-called “sweatshops” where workers are subjected to long hours in unsafe conditions at paltry wages. Globalization and free trade are seen as the root cause of such poor conditions because it is when very poor countries join the global economy that industrialization begins. Prior to such industrialization, according to the romanticized views of the anti-globalization crowd anyway, citizens of the undeveloped countries lived great rural lives off the land. In effectively a Marxist tone, the argument is that exploitation didn’t arise until workers were shoved into factories where their surplus labor was expropriated by the evil capitalist. While this is technically true (insofar as Marx’s technical definition of exploitation just is the expropriation of a worker’s surplus labor by another) even just one conversation with a “sweatshop” worker who previously lived in a rural area will provide a quite different story.

The common economist retort to these claims of exploitation is well known. The subtitle of a short article by Paul Krugman sums up the view: “Bad jobs at bad wages are better than no jobs at all.”²⁰⁶ As Pogge’s analysis of harm conceptions indicates, the economist will appeal to a diachronic view of harm to say that the workers have been made better off, even if they are still not up to par with their developed world counterparts. But to claim that a worker has been made better off does not amount to the

²⁰⁶ Paul Krugman, “In Praise of Cheap Labor: Bad jobs at bad wages are better than no jobs at all,” *Slate Magazine* (March 21, 1997).

claim that the worker is not being exploited, especially under the theory of structural equity.²⁰⁷ Thus, to provide a thorough defense of sweatshops it will be necessary to make use of the principles of structural equity. I will turn to such a defense now.

As I discussed above, structural equity requires that the overall structure of mutual market reliance be fair, but that particular transactions may be fair or unfair without amounting to a claim against structural equity. This can be applied to a defense of sweatshops in two ways. First, it may be argued that if an underdeveloped country integrates itself into the global economy it can expect significant development and the benefits that follow, something it could not expect absent integration. Therefore, the short term use of sweatshops is justified within the overall structure because the gains to national wealth are sufficient enough and fair enough in comparison with other members of the global economy. Second, it can be argued that a particular worker, by integrating herself into the global economy by working at a sweatshop that arose as her country joined the global economy can expect real and sufficient long-term benefits that offset the short term exploitation. I will discuss each of these approaches in turn.

The first approach focuses on the third principle of structural equity and the overall benefits of economic development. As the previous two chapters have indicated, economic growth and development are absolutely essential to the reduction of poverty and its related harms. Thus, the argument that sweatshops are unsafe or harmful to the worker's health is compensated for by the fact that engagement in the global economy will reduce poverty, which reduces the risk of malnutrition and increases access to health

²⁰⁷ Aaron James, "How to Defend Sweatshop Labor: Fairness in the Global Economy," *UC-Irvine Working Paper*, access <https://webfiles.uci.edu/ajjames/Sweatshops.doc> .

care, clean water and shelter. Such benefits could not be expected absent market integration and as such require some sort of burden on the integrating economy. Additionally, sweatshops benefit overall development by raising the standards of living over time through systemic spillover effects and increased productivity. Additionally, they raise rural wages by drawing people to urban areas for work and raise urban wages by increasing productivity and providing gainful employment to citizens that result, inevitably, in a shrinking pool of skilled workers that firms must compete to employ.²⁰⁸

But such a response focused on overall development will not suffice for most people who oppose sweatshops. The concern isn't that the whole society is being exploited, but that individual workers are being exploited and such exploitation cannot be justified on the grounds that the rest of society benefits. But if the worker herself can expect real and sufficient benefits over time, then her initial investment may be justified. Indeed, under the theory of structural equity, a worker may be exploited (in the technical sense) if and only if such exploitation is done as part of a society-wide fair system of cooperation returning real and sufficient benefits to *that* worker over time.²⁰⁹ The question that arises, then, is how to determine if the benefits are sufficient enough. First, whereas an economist may say that a worker simply being paid more than she otherwise would be is enough to consider the benefit real, structural equity asks us to determine if a worker's low wages rise high enough quickly enough to justify the initial exploitation.²¹⁰

²⁰⁸ Ibid., 5-6.

²⁰⁹ Ibid., 3.

²¹⁰ Ibid., 5.

To make this determination, James's theory of structural equity includes a mechanism for justifying what he has called a worker's "market wage disadvantage". This is a measure of the difference between the worker's pay in a managed (or autarkic) economy and a market-based one. Assuming the measure is in fact negative (so that she is paid more in the managed economy), such a disadvantage can be justified if any of the following three circumstances are met: (1) the expected future increase in the market wage is at a high enough rate and level that it compensates for the present disadvantage; (2) the expected future non-wage benefits (such as greater access to healthcare) compensate for the present disadvantage; or (3) others, equally poor or poorer, could expect to benefit in wage or non-wage terms. For instance, if low wages lead to a drastic increase in gainful employment this third condition may be met, even though each particular worker may not have legitimate expectations to condition one or two.

These conditions help to better understand how it is possible to determine if the future benefits justify the current exploitation. In the case of the first condition, if we assume the initial market wage disadvantage is \$5 a day (so the worker would get paid \$5 more per day if her economy were not market-based), then such a disadvantage can be justified if she can justifiably expect to be getting paid more than the managed economy wage in a relatively short time and that wage will not decline over time. Since wages in a managed economy are unlikely to change much, because productivity and efficiency do not often change a lot and because national wealth is unlikely to increase, a market wage that is initially lower is justified because it is likely to increase. If it increases above the managed economy wage within the worker's lifetime such that she will benefit from the

increase for some time, then she would prefer, and we should consider fair, her initial market wage disadvantage.

The second condition would be a bit more difficult to clearly measure. A measure such as life expectancy or “quality of life” (if such a thing could be legitimately measured) may make this condition easier to employ. Lacking such a measure, however, there is at least one other plausible way to make use of this condition. Let’s assume that in the managed economy the worker must pay \$10 a month for healthcare and \$5 a month for access to clean water. If the market wage disadvantage is still \$5 a day, as it was in the above example, but there is no expectation for the market wage to increase then the disadvantage can be justified if the cost of healthcare or clean water declines sufficiently. If the worker inevitably is keeping more money in her pocket, rather than spending it on necessary goods and services, then she isn’t being exploited since she receives real tangible benefits in comparison to the feasible alternative (a managed economy).

The final condition really fits back into the initial justification for sweatshop labor on the grounds that it benefits the society’s development, and as such I will not make use of it here to justify an individual’s exploitation. But one extension that can be made from it is that a worker’s exploitation may be justified even if she does not receive sufficient future benefits if she can justifiably expect her progeny to receive ample benefits. Thus, while condition three allows any members of society, assuming they are equally poor or poorer, to benefit as a justification, it may be more legitimate to say that a parent may be justifiably exploited if such exploitation creates a better life for her children.

Therefore, while the previous chapters sought to give pause to the claim that sweatshop labor (and free trade generally) cannot benefit the worker by arguing for its positive benefits over time, what I have sought to do here is argue against the claim that even if a worker receives long-term benefits she is still being treated unfairly. Under the theory of structural equity, it is in fact true that if a worker receives real and sufficient benefits over time then she is not being exploited. To view exploitation atemporally, as those opposed to sweatshops seem to do, is to do a disservice to those individuals who have freely chosen to work in sweatshop conditions. As New York Times reporters Nicholas Kristof and Sheryl WuDunn, at one time campaigners against sweatshops, explain:

In time, though, we came to accept the view supported by most Asians: that the campaign against sweatshops risks harming the very people it is intended to help.... Those sweatshops tended to generate the wealth to solve the problems they created... it may sound silly to say that sweatshops offer a route to prosperity, when wages in the poorest countries are sometimes less than \$1 per day. Still, for an impoverished Indonesian or Bangladeshi woman with a handful of kids who would otherwise drop out of school and risk dying of mundane diseases like diarrhea, \$1 or \$2 a day can be a life-transforming wage.²¹¹

When concerns of “fairness” create a situation that is actually worse for the very people who are supposedly being treated unfairly those individuals decrying unfairness need to take a step back and ask who they really care about: the exploited worker, or their principled selves.

²¹¹ Nicholas Kristof and Sheryl WuDunn, *Thunder from the East: Portrait of a Rising Asia* (New York: Vintage Press, 2001), 70-71.

3. Protectionism in the Developed World

On top of the fairness of worker exploitation, those critical of the global market economy may argue that there exists unfairness in the treatment of the developing world by the developed world. In a sense, it could be argued, the developed world is “kicking away the ladder” that led to their development by urging the developing world to liberalize trade while simultaneously maintaining some protectionist barriers themselves. This sort of fairness concern requires the view of fairness that, as discussed above, economists implicitly oppose. This is an issue of “fair reciprocity” in some sense, but also incorporates a non-egalitarian view as it argues that the developing world should not be asked to reduce protectionist barriers until the developed world has fully eliminated all its barriers. I will defend the argument as a whole, since it is a claim to fair reciprocity but it simply construes what fair reciprocity would be as something quite different from a *quid pro quo*.

I have already explained why the World Trade Organization and the global economy it makes possible should not be viewed on egalitarian terms. Specifically, the WTO encourages preferential treatment for developing countries. Thus, it is not necessarily a problem that this fair reciprocity claim is non-egalitarian. In fact, to say that the developed world should continue to liberalize trade while the developing world either stops or slows down is seemingly fitting with the WTO preference for the developing world. The WTO actually already has different gradual reduction tables for different levels of economies, including a separation between developing countries and the least

developed countries.²¹² Additionally, the current average tariff rate in the developed world is significantly lower than in the developing world, which is why this fairness concern is by necessity non-egalitarian.

The upshot of the above discussion is that the argument for the unilateral elimination of developed world protection must rest on two questionable assumptions: (1) Removal of trade barriers is harmful to the country that removes them; or (2) Developed World barriers are so pervasive or harmful that absent their removal the developing world will be unable to properly integrate into the global economy. The first assumption applies if the supporter of this fairness argument believes that the developed world should eliminate barriers while the developing world maintains theirs in the hope of “catching up”, since to catch up implies that protection is helping the economy and liberalization would harm it. The second assumption applies most strongly to the issue of agricultural subsidies in the European Union and United States, whereby farmers in those developed areas are able to undercut farmers in the developing world due to government support, effectively denying the developing world penetration into the global agricultural market. But it may be taken more generally to say that so long as the developed world continues to protect some industries, even with modest protections, due to their higher level of productivity and technology they will always keep fledgling industries in the developing world out of the market. I will criticize each assumption in turn.

The whole of the first assumption is refuted by what has been said in the previous chapters. It is simply not the case that liberalization is, overall, harmful to the country that

²¹² World Trade Organisation, *Marrakesh Protocol to the General Agreement on Tariffs and Trade 1994*, WTO Legal Text, 1994. Access http://www.wto.org/english/docs_e/legal_e/13-mprot.pdf.

liberalizes trade. Certainly particular industries may suffer, but others will flourish and the country, as a whole, will flourish. This is why economists are skeptical of the applicability of fairness, construed as fair reciprocity, to trade. The basic argument for free trade is not multilateral but unilateral. The value of trade comes from imports, and exports simply pay for imports.²¹³ Thus, even if no other country liberalizes trade there is still value in unilaterally liberalizing trade. Of course the benefits of trade accrue to a greater extent and quicker when all those involved liberalize, but it is not necessary. Additionally, as was discussed in chapter two, a large and growing amount of trade for developing countries is with other developing countries. If trade liberalization benefits a country's trade partners at all, then it would be the case that liberalization in the developing world would benefit developing countries. Not much else needs to be said about this assumption, since so much has been said about its underlying claim previously.

The second assumption, however, is more problematic. It can admit the benefits of unilateral liberalization while arguing that the pervasiveness of the developed world's protectionism is so great that it at least mitigates the benefits that could accrue. For instance, it could be argued that even if the developing world were to fully liberalize trade, so long as the developed world, the European Union and United States in particular, maintain their agricultural subsidies the developing world will be unable to successfully develop. So long as subsidies keep world market prices down and allow farmers in the developed world to actually charge less for their products than their production cost, the developing world will never be able to establish sustainably growing

²¹³ Aaron James, "Global Economic Fairness: Internal Principles," 13.

economies. The above example requires that agriculture is a necessary part of a sustainably growing economy, but the general argument could apply to any economic sector and, if many sectors are taken together, the argument gains greater force.

I would like to deal with the agriculture subsidies issue first, as it is an issue discussed to a great extent in the literature against globalization and the WTO. Basically, the subsidies given to farmers in the United States and European Union make it unprofitable to be in the agricultural sector in the developing world. This is first because world market prices decline as subsidized farmers sell their goods cheaper. This applies regardless of liberalization. But liberalization in the developing world could make such a situation worse, because now not only will the farmer in the developing country be unable to compete on the international market but she may lose her ability to compete domestically, as liberalization allows the artificially cheap agricultural products into the farmer's domestic market. There are at least two ways to defeat this argument.

First, the overall assumption of the argument is that agriculture is an important component of economic development. This is problematic, as 80 percent of the exports in the developing world are in manufactures, a good portion of the 20 percent left over is in services and very little is in agriculture.²¹⁴ Nonetheless, many of the countries in the developing world are growing sustainably and finding great success in the reduction of poverty and its associated harms. This is because manufactures and services offer better prospects of equitable and rapid growth. Prices are not as likely to fluctuate as they do for agricultural goods and because manufactures and services create wage schemes that

²¹⁴ Paul Collier, "The Bottom Billion," 81.

farming is often lacking worker's incomes are more sustainable. Additionally, because most developing countries, especially early on, are marked by a great deal of unproductive labor and manufactures and services are more labor intensive than alternatives, including agriculture, they can put a greater number of people to work earning incomes. Therefore, agriculture is not required for economic growth nor is it preferable.

One might respond to the above criticism by arguing that there is some sort of right to a particular livelihood so that even if agriculture is not necessary preferable for economic growth and poverty reduction, it ought to be maintained. While I think any case being made for someone having a right to a particular job will be quite dubious, I would prefer to respond to this view by arguing that not only would the removal of agricultural subsidies in the developed world be unnecessary for growth in the developing world, but it would actually harm such growth. As mentioned above, the result of agricultural subsidies is that food prices globally decline. This means that poor people pay less for food, something absolutely essential to their continued existence. In 1999, 45 of the 49 least-developed countries were net-food-importers, meaning they imported more food than they exported.²¹⁵ As food prices increase it means it moves out of reach of more and more people. It is quite difficult to escape poverty so long as you are malnourished or starving, and thus anything that keeps food prices low would seem to be a benefit to the poorest people in the world.

²¹⁵ Malgorzata Kurjanska and Mathias Risse, "Fairness in Trade II: Export Subsidies and the Fair Trade Movement," *Politics, Philosophy and Economics* 7, no. 1 (2008). 29-57. 34.

Additionally, the majority of gains from eliminating subsidies accrue to the country eliminating the subsidy.²¹⁶ If the United States were to eliminate agricultural subsidies, for instance, the United States taxpayer would benefit by not having her tax money support an inefficient industry. While subsidized food purchased by other countries is truly cheaper than the world market price, for the domestic purchaser of subsidized food no such benefit arises. Certainly the price they pay at the market is lower, but they are paying an additional amount through taxes that are being redistributed to industrial agriculture. Therefore, the elimination of agricultural subsidies in the developed world would have little, if any, benefit to the developing world but would certainly benefit those who most often call for their elimination, the middle-class individual living in America or Europe.

While the overall argument based around the developed world's hypocrisy regarding protectionism focuses on agricultural subsidies, the argument could be made more general. What if the barriers to trade in the developed world regarding textiles, for instance, made it impossible for a developing country to engage in that market? Well, the barriers would have to be pervasive enough that they actually would eliminate market penetration for the good. In the case of subsidies this can occur because world market prices go down, but then we are left asking if it is better to allow all people to have access to a good or allow a few producers to engage in the market. In the case of tariffs and quotas, however, there would have to be evidence that the market(s) in which the tariffs or quotas exist are necessary for the textile industry in a developing country to succeed. It

²¹⁶ Douglas A. Irwin, *Free Trade Under Fire*, 201.

also assumes that there isn't still a way for the industry to penetrate a protected market, such as by making the product cheaply enough to compensate for the tariff. Considering trade between developing countries is quite large and growing, the evidence that a particular developed country's market for a particular good is essential to the success of the industry will be harder and harder to come by. Therefore, it is unlikely that a genuine case can be made that a particular barrier in the developed world is effectively shutting down a developing country's ability to reap the benefits of unilateral trade liberalization.

One may ask, however, that even if it doesn't have any major implications for the development of particular countries, is it fair? Well, under the conception used by those in favor of the argument it would not be fair, but then that conception of fairness doesn't apply since fair reciprocity would have to prove that there are harms associated with unilateral trade liberalization. Structural equity may still apply, however. According to structural equity, though, the consequences determine whether something is fair or not (that was the third assumption that must be true for fairness to apply to the global economy). Therefore, if no legitimate case can be made for protection in the developed world producing negative consequences for the developing world it is unlikely that the theory of structural equity can produce a claim of unfairness. Especially since it has been shown that not only does developed world protectionism produce no harmful consequences, but may in fact produce positive ones (such as lowering the costs of goods) it would seem that perhaps the current arrangement is more fair than one where the developed world lifts its barriers.

Such a view very likely applies to agricultural subsidies but perhaps not to tariff or quota barriers. In the case of these barriers it may be the case that the consequences are

negligible but it is difficult to see how they could be beneficial and in such a case it is a justified fairness claim to argue for the removal of import barriers in the developed world. One possible way to absolve the developed world of this obligation is to argue that the import barriers those countries have in place are beneficial to the developing world by forcing them to seek alternative, more profitable industries. This would be an empirical question, and one that is likely to hold throughout. As such, I will maintain that it is justified to urge the developed world to (at least) remove its import barriers.

Even if it is a legitimate claim to make, however, the benefits of unilateral liberalization, as discussed above, means that such a claim does not entail that the developing world ought not liberalize. The developing world will still see benefits from liberalization regardless of what the developed world does, and as such should pursue trade liberalization unilaterally while continuing to urge the developed world to reform as well. Thus, structural equity provides a mechanism for making the fairness claim that defenders of fair reciprocity want but does not allow those same defenders to claim that the fairness claim means the developing world need not liberalize.

4. Fair Trade

According to structural equity, it is neither legitimate to claim that because the developed world isn't fully liberalized the developing world should not liberalize nor is it legitimate to claim that sweatshop workers are being exploited. Both of these arguments were negative claims *against* free trade and globalization. The final issue I will examine under the framework of structural equity is a more positive claim. It is the argument that those of us in the developed world ought to be paying more than the world market price for some of our goods in order to provide a better life to the poor farmers and artisans

producing the goods. Put simply, it is the claim that by purchasing so-called “Fair Trade” goods we are doing more good for the developing world (or at least individuals in it) than by purchasing just regular goods.

I will specifically isolate my discussion to agricultural fair trade, as the issues it raises are more controversial than fair trade in jewelry and the like. Fair trade, generally, but especially in relation to agriculture, is very similar to subsidies. Both fair trade and subsidies provide additional money to a producer that distorts the price of the good. Both are economically inefficient, as they keep people or industries afloat that would hypothetically collapse without the additional money.²¹⁷ One important difference, however, is that whereas subsidies are paid out by the government, with tax money, the additional money paid for Fair Trade goods is paid by the consumer who chooses to purchase such goods. So whereas subsidies effectively tax the consumer for the sake of the producer Fair Trade is a voluntary arrangement where the consumer makes a conscious decision to pay more to the producer.

The general argument in favor of Fair Trade assumes that farmers are currently not getting paid a “living wage” or in some way or another “what they deserve” for their work. In response, farmers have formed Fair Trade cooperatives that are certified and labeled so as to encourage those who claim to care about the plight of poor farmers can make the decision to support them to a greater extent. It is undeniable to say that the purchase of Fair Trade goods puts more money into the pocket of Fair Trade farmers. However, two issues arise in the justification of Fair Trade: (1) are there some sort of

²¹⁷ Malgorzata Kurjanska and Mathias Risse, “Fairness in Trade II: Export Subsidies and the Fair Trade Movement,” 31.

negative consequences to it that may outweigh the individual benefit? And (2) is there an obligation imposed by principles of fairness to purchase Fair Trade, or is it simply a praise-worthy choice? I will answer each of these questions in turn.

The first question emphasizes the relationship between Fair Trade and overall economic development. While it is certainly true that individual farmers benefit from the sale of Fair Trade goods, it is quite possible that Fair Trade actually harms the overall economic development of a country and thus punishes a great majority of the people in that country for the sake of the few who produce Fair Trade goods. Some work has been done to oppose this view, including studies concluding that the existence of Fair Trade farmers can actually benefit non-Fair Trade farmers as well.²¹⁸ Additionally, it has been argued that if Fair Trade becomes popular enough then it may become the case that for a farmer to compete she must produce Fair Trade crops, thus raising all farmer's incomes.²¹⁹

Such studies help to alleviate the concern, by indicating how Fair Trade agriculture can have benefits outside of the Fair Trade farmers, but it does nothing to discuss the overall development prospects of a country. And even supporters of Fair Trade, such as Nicole Hassoun, admit that if Fair Trade goods actually do hinder development or, at least, are not a part of the best development strategy for the poor, then they should be rejected.²²⁰ And it may indeed be the case that Fair Trade actually hinders

²¹⁸ Nicole Hassoun, "Making Free Trade Fair," Carnegie Mellon Department of Philosophy Working Paper 356 (2011). [HTTP://repository.cmu.edu/philosophy/356](http://repository.cmu.edu/philosophy/356). 20.

²¹⁹ *Ibid.*, 15.

²²⁰ *Ibid.*, 12.

development for two main interrelated reasons: it trades off with more important crops and it may trade off with alternative, more efficient industries such as manufactures.

Fair Trade, first and foremost, is almost exclusively in what I call luxury crops. Luxury crops have no direct nutritional benefit and cannot be used by the very people growing them to provide subsistence. Tea and coffee are the best examples of these luxury crops, but even some exotic fruits may fit this category based on a similar result. That result, specifically, is that many farmers who would otherwise grow staple crops, those crops that are eaten regularly and make up the majority of a person's diet, move into luxury crops because they pay more. Indeed, Starbucks is the largest purchaser of Fair Trade coffee in North America, but they are not making any demands for Fair Trade potatoes or other such staple crops. The inevitable result of such a process is twofold, one which concerns me and one which I believe will concern those people who generally favor Fair Trade. First, it means that a country may legitimately not develop. Absent being able to provide a population with the necessary foodstuffs, which may require domestic production, it is quite difficult to grow economically. Additionally, the move to an industry simply because it artificially pays more means that there is a move towards less efficient industries, likely at the cost of more efficient ones.²²¹ The result then is a disruption in the process of developing a comparative advantage, and as mentioned previously agriculture specifically is problematic for equitable and rapid development and poverty reduction.

²²¹ Malgorzata Kurjanska and Mathias Risse, "Fairness in Trade II: Export Subsidies and the Fair Trade Movement," 31.

The second concern, which is of little issue to me or others sympathetic to global market integration, is that a country that moves away from staple crops into luxury crops will likely become dependent upon other countries for its basic necessities. Now the law of comparative advantage tells us that if a country can do better with one industry at the expense of another, no matter the industry, it should do so. And, considering world market prices for food may be lower than domestic prices, due to subsidies and other manipulations, it may be economically beneficial to rely on foreign countries for one's basic foods. Indeed, countries lacking in arable land but not in unskilled labor would do better to focus on labor-intensive manufactures and import its food. However, many of the proponents of Fair Trade are also proponents of self-sufficiency or another, similar notion. Just as they often are those promoting food security for their own country, they would be appalled to see a poor nation completely reliant upon other countries for their basic foodstuffs. But that is precisely the result Fair Trade may have.

What, then, is to be made of Fair Trade and poverty reduction? Certainly it benefits the select few individuals who sell Fair Trade products, but it quite possibly sets the entire country's development process back. Structural equity may be able to help sort this issue out. First, it is clearly an empirical question whether or not Fair Trade is a part of the best development strategy for a particular country, and as such it cannot be ruled out *a priori*. Beyond that, however, the second question I posed earlier becomes important: Is there an obligation imposed by the principles of fairness to either support or oppose Fair Trade?

Since Fair Trade may not always be a part of the best development strategy for a particular country, it is unlikely that any general obligation can be placed either for or

against supporting Fair Trade. Additionally, Fair Trade makes up such a small portion of the economy currently that it is unlikely that even if it has negative consequences they are unlikely to rise to any great level. As such, some economists argue that while Fair Trade is unjustifiable it is of negligible impact either way so it is relatively unimportant.²²² Under these two assumptions, it seems unlikely that anything comprehensive can be said of the fairness issues surrounding Fair Trade. But structural equity may offer a few insights.

First, structural equity demands that the gains of trade for a single country are fairly distributed within that country. Fair Trade may violate this dictate, by unfairly privileging a certain subsection of the economy, namely Fair Trade farmers. Especially in the case of a country that produces the same good in both Fair Trade and non-Fair Trade forms, the work isn't any harder or more intensive or anything of the sort and as such it would be unfair to the non-Fair Trade farmer to not give her an equal share compared to the Fair Trade farmer. In such a case, it can be said that Fair Trade is, in fact, unfair and not justifiable under the current economic structure.

Structural equity also calls upon all members of the global economy to ensure a fair distribution of national wealth, relative to relevant factors. Under this principle, it could be argued that Fair Trade, or simply the higher price for particular goods, is justified as a means of ensuring a fair distribution of national wealth across nations. Of course even if this is true, the above principle of fair distribution within the nation-state would be violated when the higher national wealth isn't equally distributed.

²²² Ibid., also see Nicole Hassoun, "Making Free Trade Fair".

Finally, structural equity explicitly denies the possibility that an individual in one country has a claim of fairness on an individual in another country. As such, it cannot be said that a farmer in the developing world has a claim against a consumer in the developed world to pay more than the world market price for her good. Indeed, while a worker may reasonably demand “the best possible terms of integration for his [sic] society,” this cannot cash out into an increase in the value of any particular good, but merely indicates that the society, as a whole, receives the best possible terms, which may not include favored status for the crop the farmer grows.²²³

Structural equity, then, seems to actually oppose Fair Trade, but does so on relatively weak grounds. Because the value of Fair Trade is context specific it may be best not to see it as an issue of fairness whatsoever, but rather view it as the economist does. It is seemingly negative for the overall economy but is negligibly so and as such is of little concern for issues of fairness or development. Such a conclusion is certainly much weaker than what the Fair Trade advocates would want, but it is in fact the only conclusion that can be reached without arguing that it is justified that a select few individuals profit while the rest of the society is either harmed or not equally benefitted.

5. Conclusion

This chapter has focused on developing and applying a particular theory of fairness for the global economy. It was argued that any theory of fairness for the global economy to apply it must be internal, meaning it does not call into question the existence of the system as it is. Additionally, the theory had to explain harm in the global economy

²²³ Aaron James, “How to Defend Sweatshop Labor,” 10.

in subjunctive, rather than diachronic terms. This theory of fairness, based on the notion of structural equity, was then applied to three specific fairness concerns in the global economy. According to structural equity, sweatshop labor is not necessarily harmful or unfair, protectionism in the developed world, while something to be opposed, is not strictly unfair and finally the Fair Trade movement is not strictly fair, but is minimally unfair and as such is not problematic so long as it remains a small portion of the overall economy.

CONCLUSION

This thesis has sought to unite the philosophic and economic literature on the relationship of the global economy to poverty reduction efforts for the developing world. Chapter 1 provided empirical case studies of the successes of trade liberalization and set out the framework for understanding trade protectionism, trade liberalization and poverty in the current system. Chapter 2 then made use of that framework to argue that protectionism actually militates against poverty reduction in three key ways, while liberalized trade offers a preferable alternative on all three counts. In the short term protectionism reduces national wealth and redistributes wealth from the impoverished consumer to the wealthy producer. In the long term protectionism prevents sustained growth and poverty reduction, while liberalized trade is in fact a necessary condition of such long term growth and poverty reduction. Finally, protectionism actually props up bad governments and promotes illicit activities while liberalized trade reduces the propensity for corruption and smuggling, which harm efforts at poverty reduction.

Chapter 3 concluded with the development of a theory of fairness in the global economy and its application to three particular aspects of the global economy. Worker exploitation in “sweatshops” was justified as fair, protectionism in the developed world was deemed unjustified but not a reason to object to liberalization in the developing world, and the Fair Trade movement was deemed negligibly unfair. The end result of all that has been said is that while neither protectionism nor trade liberalization can succeed

in reducing poverty on their own merits, trade liberalization puts a developing country in the best position possible to successfully reduce poverty.