DOMESTIC DIMENSIONS OF THE TRADE LIBERALIZATION AGENDA: AN EXPLORATION[*]

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Introduction

The past quarter of a century has witnessed among many countries across the development spectrum an unprecedented level of activity in the process of trade liberalization. In many respects, this most recent phase of global integration among economies stands out in comparison to all other phases that have occurred in the past few centuries.[1] Most notably, for the first time more than 180 States have engaged in the process of integrating their economies with those of their partners. The second crucial feature of the current phase of globalization is the backing it has received from multilateral institutions. While the multilateral financial institutions provided the initial impetus for the globalization process, the multilateral trading system – now having a widely accepted institution of its own – has provided a forum for countries to find ways of deepening and widening the process of trade (and investment) liberalization.

However, despite its wide following, the liberalization agenda faces a number of challenges, according to Fischer (2003). Stiglitz (1998), in his own inimitable style, commented that Washington Consensus that provided the philosophical underpinnings of the trade liberalization agenda, "was incomplete and sometimes even misleading"[2]. Elaborating their positions, the commentators have alluded to the range of trade liberalization policies that must be adopted to ensure more inclusive outcomes (Commission on Growth and Development, 2008). In the author's view, a more generic criticism of the policies of globalization in general, and that of trade liberalisation in particular, is that in designing these polices, little effort was made to include the development dimension. It may be pointed out in this regard that the 23 founding members of the multilateral trading system established as the General Agreement on Tariffs and Trade (GATT) provided a development context to the trade liberalization agenda. Thus, the GATT signatories stated in the preamble to the Agreement that "their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding the production and exchange of goods" and that "substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce" were the means to achieve the aforementioned objectives (United Nations, 1947).

[*] Paper was first presented in the "Research Workshop on Emerging Issues for Developing Countries in Asia-Pacific", organised by UNESCAP in Macao in December 2007

[1] See Fischer, 2003, p. 3, for a brief account of the earlier phase of economic globalization that thrived before 1914.

[2] See Stiglitz, 1998, p. 33.

The objectives set by the GATT signatories were elaborated further in the preamble to the Agreement establishing the World Trade Organization (WTO).[3] Ironically, a development agenda was formally accepted by WTO six years after the organization began functioning. The so-called Doha Development Agenda (DDA) became the basis of the work programme agreed to by the WTO members at the conclusion of the WTO Ministerial Conference in Doha. One of the often articulated issues under discussion as a part of the DDA was the need to adopt instruments that would allow developing countries the policy space to address their domestic imperatives. However, more than seven years since being launched, the Doha Round negotiations are heading for a prolonged phase of "suspended animation", essentially because no agreement appears likely on issues that would help make the multilateral trading system more "development" friendly.

This paper makes an attempt to review the policies that could address some of the domestic imperatives of developing countries that have embarked on the path of trade liberalization. It should be emphasized here that it is the efforts by countries to orient their domestic economies to the meet the requirements of the global marketplace that have determined their relative performance in securing additional market access. Thus, pre-occupation with their trade liberalization efforts on the part of most developing countries has meant that, barring a few advanced developing nations, most of these countries have registered modest gains during the past decade in goods and services trade. While China has been able to quadruple its share of global merchandise trade since the mid-1990s, India has likewise been able to do in the global market for commercial services. What this paper therefore tries to highlight is that domestic policy initiatives can play critical roles in determining the economic fortunes of the developing countries pursuing the trade liberalization agenda.

The above-mentioned objective of this paper has been developed over several sections. In the first place, a critical examination is made of the foundations of the Washington Consensus, which provided the framework for policies of trade (and investment) liberalization. In fact, there were two problems with the Washington Consensus: (a) the framework was too narrowly specified; and (b) the path followed by the policy makers (supposedly modelled on the Washington Consensus) while embarking on the policy of trade liberalization mostly ignored the critical elements of the Washington Consensus framework that had a bearing on the functioning of the domestic economies. Section A discusses the need to synergize the domestic productive forces as countries implement their trade liberalization agenda. It is argued here that domestic policy initiatives need to be an integral part of trade policy-making efforts of developing countries, as they provide critical inputs to the enhancement of the competitive strengths of their production enterprises. A body of literature argues, in fact, that developing countries would do well to adopt appropriate policy instruments that would enable them to provide the environment necessary for improving the competitive edge of their enterprises. However, there is little evidence emerging from the

[3] The objectives of WTO, as spelt out in the preamble to the Agreement that established the organization, were: (a) raise standards of living; (b) ensure full employment; (c) support a large and steadily growing volume of real income and effective demand; (d) expand production of, and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development; and (e) protect and preserve the environment. It was further stated that the organization would seek to enhance the means of realizing the above-mentioned objectives "in a manner consistent with their respective needs and concerns at different levels of economic development" (WTO, 1995).

developing world that the policy makers have indeed recognized that synergies need to be developed between trade policies and those that are put in place for the rest of the economy.

Together with building synergies with the domestic economy, policy-making should take into consideration measures that are needed to enable developing countries to provide "strategic" advantages to their domestic players in a market that is rife with distortions. To illustrate this point, the need to devise policies of "strategic" intervention in two markets, i.e., agriculture and technology, is discussed. The author's view is that in the area of technology, developing countries would do well to emulate the developed countries where the State continues to play an active role in improving the technological sinews of the production units in all sectors. The criticality for so doing can be well understood in an age when the technology factor has been well-recognized as being the prime motive force for development. In agriculture, developing countries would need to adopt appropriate instruments to meet the challenges caused by policy-induced distortions. These instruments are needed to counter the slew of subsidies granted by the developed countries as well as the developed-bias against agriculture that has affected the performance of agriculture in most developing countries.

A. Washington Consensus and its "mutations"

Since the early 1990s, the debates on development strategies to be pursued by developing countries, in particular, have witnessed changes in paradigm as never before. Pursuit of development goals until then was largely dominated by the model that had put the State at the centre of economic activities. The State was expected to play an active role in formulating development policies and to provide the wherewithal to implement these policies.

Development strategies in most developing countries were thus built on a strong public sector that was guided by the "interventionist" State. The aim of State intervention was to direct the economic processes towards outcomes that were expected to respond to social and human needs, and, above-all, fulfil the requirements of long-term development. These objectives provided the justification for putting in place policies aimed at developing domestic industries as well as measures necessary for protecting these infant industries. However, although industry was protected by trade policy instruments as well as by domestic policy measures that often discriminated against operations of foreign firms, in a number of developing countries – including some of the more active users of protectionist policies such as India – efforts to increase exports were never abandoned.

This development policy framework was cast aside following the developments that first surfaced in the Latin American region. The failure of the governments to manage their economies in the face of a financial crisis that, many would argue, stemmed from imprudent lending by the private financial markets raised serious questions regarding the State-run economic system. Commentators were quick to point out that "government failure" was inevitable given the series of omissions and commissions that the governments had committed (Krueger, 1990). In addition, it was the assumption of "government failure" that formed the basis of the policy package that the multilateral financial institutions had put together while extending structural adjustment loans to the affected countries. The so-called "Washington Consensus" package sought to reduce the role of government by encouraging larger play by market forces and the introduction of time-lines for countries to undertake trade liberalization. The "Washington Consensus" became the standard bearer for the economic reform programmes launched by the developing countries during the 1980s and 1990s. This was the case just as Williamson (2002), the originator of the term, noted when he said the policy package was "originally presented as a summary of what most people in Washington believed Latin America (not all countries) ought to be undertaking as of 1989 (not at all times)".[4]

A second, more significant aspect of the Williamson framework lay in its details. The framework was just about a complete reliance on the market, as it also emphasized the specific role of policies during economic reforms. Thus, the reordering of government priorities was sought by cutting down on the wasteful and non-essential activities that the State was involved in when it was controlling the commanding heights of the economy. The priorities for the government, according to Williamson, had to be building up the social and physical infrastructure. More concretely, Williamson's view was that "policy reform with regard to public expenditure" should "consist of switching expenditure from subsidies towards education and heath (especially to benefit the disadvantaged) and infrastructure investment".

The framework for trade policy reforms appearing in Williamson's schema requires attention as it proposes an approach that is mindful of the usual problems with which the developing countries are saddled. The first step concerns infant industries, which, according to Williamson, may merit substantial but strictly temporary protection. Second, a moderate general tariff (in the range of 10-20 per cent, with little dispersion) might be accepted as a mechanism for providing a bias towards diversifying the industrial base without threatening serious costs. Williamson also voted in favour of sequencing import liberalization, arguing for the speed of liberalization to be determined endogenously, depending on how much the balance of payments would be able tolerate.

More recently, several commentators, including the proponent of the idea, suggested modifications in the original framework of the Washington Consensus, terming the original framework as being "excessively narrow". A major contribution in this regard was made by Stiglitz who drew up the elements of what he called the "post-Washington Consensus", which essentially entailed broadening the goals and including more instruments. However, possibly the most important contribution of Stiglitz (1998) was that he provided a framework aimed at making the markets work in a manner that met the imperatives of development.

Stiglitz introduced two sets of modifications in the Williamson framework. One, the critical elements of the Washington Consensus, and in particular the adoption of policies on trade liberalization and privatization, were not viewed as ends in themselves, but as necessary prerequisites for promoting better functioning markets. This was done, for example, by critically evaluating the ability of the trade liberalization strategy to meet its professed objectives of competition and promoting efficiencies. Stiglitz argued that the lack of competition in the domestic markets of countries that were liberalizing might, in fact, result in outcomes that were contrary to those professed by the votaries of trade liberalization. It was therefore necessary to not only promote competition in domestic markets but to also take steps for establishing regulatory regimes to check abuse of market power. The second set of modifications recognized that governments needed to complement

[4] This quote was taken by the author from an Internet document accessed at http://www.iie.com/publications/papers/paper.cfm?ResearchID=488

the market. In fact, Stiglitz argued, there was a case for making governments more effective so that they could meaningfully complement the market.

A more forthright comment on the broad policy framework that countries need to adopt, particularly with regard to the role that government needs to play, was made by the Commission on Growth and Development (the Spence Report). The authors believed that the economic reforms package adopted in the past defined "the role of government too narrowly". They added that "[j]ust because governments are sometimes clumsy and sometimes errant, does not mean they should be written out of the script. On the contrary, as the economy grows and develops, active, pragmatic governments have crucial roles to play" (Commission on Growth and Development, 2008).

Perhaps the more significant aspect of the Spence Report is that it suggests that a "coherent growth strategy will...set priorities, deciding where to devote a government's energies and resources". These priorities, in the view of the Commission, "should...be country- and context-specific, responding to widely varying initial conditions" (Commission on Growth and Development, 2008).

The key issue that emerges from the above discussion is that conditions must be created to help create synergy in the domestic forces in the context of an open economy. This issue has been variedly dealt with in the available literature, and which is discussed in the following section.

B. Creating synergy in domestic productive forces

The role that policy measures can play in guiding the economic features of countries has seen a revival of support during the past few years. Commentators have argued that industrialization and economic catch-up are not generally the result of an efficient allocation of resources. A World Bank Study (2005), in commenting on the lessons gained from the 1990s, stated that "growth entails more than efficient use of resources". It pointed out that growth entailed structural transformation, diversification of production, change, risk-taking by producers, the correction of both government and market failures, and changes in policies and institutions. The study emphasized the fact that policy reforms should entail an understanding of the forces underlying growth, which could include those introduced for promoting technological catch-up or the encouragement of risk-taking that could, in turn, contribute towards faster accumulation.

In many ways, this World Bank prescription is in the nature of a retraction from the past prescription when the institution had recommended that an unfettered licence for the market forces through the polices of trade and financial liberalization together with a reduction in size for the government must, of necessity, be the way forward, "at all times and in all places" (World Bank, 2005). As the study pointed out, the growth objectives could be achieved through diverse ways, which had been amply demonstrated by a number of countries that were able to push through a successful industrialization strategy by adopting proactive policies.

Perhaps the best-documented case of successful industrialization through a proactive industrial policy is that of the Republic of Korea. Westphal (1990) argued that the selective industrial policies of the Government of the Republic of Korea had made a significant contribution to the rapid achievement of competitiveness in a number of industries. According to Westphal, industrial policy in the Republic of Korea was designed for the realization of two objectives: encouraging exports and promoting infant industries. Even more importantly, the quality of intervention enabled the industries to maintain their competitive edge.

One prominent dimension of the experience of the Republic of Korea in developing an industrial base through selective intervention was that it addressed the issue of market imperfections associated with technological change. Westphal pointed that even though there was an abundant supply of available technology through transactions involving licences, capital goods, direct investment, technical assistance and the like, elements of technology were far from being perfectly tradeable in the sense that purchase was not sufficient for effective possession. Because of the imperfect tradeability of technology, externalities related to technological development can be quite extensive. According to Westphal, additional externalities could result because demonstration effects from an initial entrant's investments in mastering new technology could greatly reduce costs for subsequent, nearby entrants.

The Republic of Korea used the policy of selective intervention to increase the country's ability to capture the dynamic economies associated with the introduction and exploitation of modern technology. The country made significant investments in the successful assimilation and adaptation of industrial technology, and consequently reaped development dividends.

Several recent studies have documented the successes that developing countries have experienced as their economies have been subjected to selective interventions. In all such studies, the State has been seen as playing the role of a prime mover in setting the development goals, while private enterprise responded to the initiatives taken by the State. One of the major problems in appreciating the relevance of the traditional industrial policy framework in the present context arises from the transformed character of the State in the developing world. The omniscient State lasted only until the end of the 1980s; since then, it has given up considerable space to market forces. In such circumstances, it is imperative that the role of the State be rewritten, particularly in the light of the limitations of the market to deliver on development. While the beginnings of this approach evident, as indicated in section C, considerably more needs to be done to identify the specific failings of the market forces that would impede the development process, especially in the developing countries..

C. A framework for addressing development imperatives

A large number of studies in recent years have tried to examine the policy framework that would appropriately address the development imperatives of developing countries in the context of the present-day global economy. An important contribution in this regard was made by Rodrik (2004), who proposed a policy framework that "maximizes economic growth while minimizing the risks that it will generate waste and rent-seeking activities". The professed importance of the Rodrik framework is that it encompasses not only the traditionally advocated industrial policies, but would also be applicable to non-traditional activities in agriculture or services. However, as elaborated below, the approach that Rodrik proposed needs to be appropriately modified in order to take into consideration the peculiarities of small enterprises, and in particular the informal sector that includes the majority of industrial and agriculture enterprises in most developing countries.

The framework that Rodrik proposed does not merely entail developing policy interventions aimed at targeting market failures, but also seeks to provide a blue-print that is effective in addressing market failures. Central to this approach is strategic collaboration between the private sector and government with the aim of revealing the obstacles and devising appropriate measures for removing them. Thus, the policy framework proposed by Rodrik is a discovery process – one where the firms and governments learn about the underlying costs and opportunities, and engage in strategic coordination. The virtues of such a partnership are increasingly being understood, as public-private partnership has been adopted as the guiding spirit by most economies.

Diversification of economic activities provides the much needed fillip to economic development. While past generations of economists argued in favour of developing countries diversifying away from primary production and into manufacturing, more recently some analysts have argued that countries develop by latching onto high-productivity goods. However, as pointed out by Rodrik, two key externalities, i.e., information externalities and coordination externalities, can pose serious impediments to the process of diversification. Therefore, diversification is unlikely to take place without directed governmental action.

Information externalities need particular attention in most developing countries, as they play a critical role in the creation of an enabling environment for diversification of the production systems in those countries. Overcoming this constraint would essentially help entrepreneurs to experiment with new product lines. In other words, they would indulge in a process that Hausmann and Rodrik (2003) called “self-discovery”.

Agriculture and the small and medium-sized enterprises (SMEs) would be the major beneficiaries of this process of “self-discovery”, since in both these sectors the majority of producers find themselves trapped in production patterns that are economically less viable. Typically, information externalities that restrict self-discovery need to be addressed through subsidized investments in new and non-traditional industries. Yet, while most analysts insist that the support for these enterprises should be narrowly focused so as to provide incentives only to the first movers, the reality in most developing countries may warrant a different approach. In such countries, State support for meeting information externalities would have to be maintained for some time in order to allow the benefits to flow in an effective manner. Such an approach would be necessary, in the author’s view, because of the preponderance of the micro-production units in agriculture and the SME sector – the two sectors that would feel the effects of information externalities the most in developing countries. Thus, if SME sector enterprises are to diversify their operations, a number of such enterprises must be able to prove that shifting into new production lines will bring in a continuous flow of returns. In other words, they would need to demonstrate that the benefits that accrue from diversification are more than mere windfalls. While governments must provide support in a sustained manner, in order to allow “diversification” to have a spread effect, they must be wary of the pitfalls of over-commitment to this process.

In order to be successful over the longer term, enterprises venturing into new and non-traditional industries must have the necessary wherewithal to overcome the technological bottlenecks. In addition to needing the resources for acquiring the technologies they need for start-up, they would require support for suitable adaptation of imported technologies to suit local conditions. The author’s opinion is that the above-mentioned imperatives can only be met through “strategic” market interventions that the State would have to make to enable technology to capture the rents that have shifted decisively in favour of the patent owners since the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights became effective. Section D deals with this issue in detail.

That coordination externalities can affect production systems in developing countries has long been recognized by development economists. It was more than half a century ago that Rosenstein-Rodan (1961), Nurkse (1961) and Scitovsky (1954) backed the "big push" model that was essentially aimed at coordinating investments. More recently, Murphy and others (1989) argued that "a programme that encourages industrialization in many sectors simultaneously can substantially boost income and welfare, even when investment in any one sector appears unprofitable".

Cluster development represents a good example of how coordination externalities can be overcome. Analysts have backed the development of clusters, as they perceive several advantages that such production systems could provide. Considerable support for cluster development has been voiced by the industrialized countries. For example, the Organisation for Economic Co-operation and Development (OECD) Focus Group on Cluster Analysis, an initiative taken in the late 1990s, explored the ways in which the synergies that could develop in a cluster could, in turn, be productively harnessed, particularly with regard to fostering innovation.

Commenting on the virtues of clusters for the United States, Porter and van Opstal (2001) argued that "achieving a more rapid pace of innovation will require explicit recognition of, and support for the critical role of States and localities in fostering clusters, or geographic concentrations of firms, suppliers and related institutions in particular fields". In their view, "clusters innovate faster because they draw on local networks that link technology, resources, information and talent".

Based on the above observations, Porter and van Opstal surmised that "clusters build the basis for specialized skills and capabilities, and enable competitive advantage in world markets". However, while the idea of promoting clusters for harnessing development potential has found wide acceptance, commentators are less in agreement with regard to the specific form of State support for the clusters. Rodrik, for example, argued that new activities rather than a sector should be the focus of State support. On the other hand, Rodriguez-Clare (2005) suggested that a State should provide support only when approached by a set of enterprises that are willing to coordinate their production activities. Alternatively, Rodriguez-Clare argued that governments could pick certain sectors for more intensive support in a problem-solving mode. In such circumstances, support can be lent for strengthening the organization, studying specific problems, identifying coordination failures and implementing simultaneous interventions in several areas.

The emerging literature on the initiatives that countries should take to enhance their development potential (as briefly discussed above) points unambiguously to the fact that countries must seek ways of harnessing their production systems by making efforts to diversify their economic activities. It should be pointed out that this policy of diversification militates against the conventional theory of trade based on comparative advantage, which insists that gains from trade are to be had from specialization. The free trade paradigm adopted of late with new fervour – which strongly advocates adherence to the comparative advantage theory and, unsurprisingly, the contours of the policy framework consistent with this theory – forms the cornerstone of the structure of the WTO regime and provides little scope for developing countries to explore new avenues for development.

This has been the nub of the arguments made by the developing countries since the establishment of WTO, and the persistence of these countries appears to have paid dividends in 2001 when the WTO members agreed to launch a new round of multilateral trade negotiations whose mandate included issues that were expected to respond to the development needs of the developing countries.[5] In recent years, however, several analysts have argued that the Doha deal could bring adverse results in vulnerable sectors for the developing countries as a whole.[6]

There is no gainsaying that if a development-friendly framework does indeed emerge at the end of the Doha Round negotiations (if they are ever concluded), a decisive move has to be made away from the existing paradigm to one that must be able to factor in the need for countries to diversify their economic activities.

D. A case for 'strategic' interventions

Holding the key to successful forays by the developing countries into the evolving global economy is a set of "strategic" interventions that governments need to implement to good effect. These interventions would allow these countries to overcome the myriad distortions that prevail in the global markets.

Where the prime motivation for introducing market-based reforms was to extricate their economies from state control and, therefore, rent-seekers spawned by the State, developing countries found that these reforms gave rise to formidable challenges that could affect their development prospects. For example, the emerging nature of the technology and knowledge market, where the increased level of protection afforded to the technology owners – particularly following the introduction of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) – has created "novo" rent seekers.

The implications of the regime of intellectual property protection have been discussed extensively in several contexts. The most prominent of these discussions have been concerned with the problem of access to medicines where the strong intellectual property regime has been seen by developing countries as an obstacle to their efforts to provide affordable medicines to their populations. It has been recognized that some countries would be constrained in their ability to procure medicines at affordable prices because they lack viable domestic production capacities. However, should those countries develop a domestic pharmaceutical industry, they may find it difficult to sustain production levels as they may not be able to procure the relevant technologies.[7]

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[5] The WTO Ministerial Declaration articulated this dimension in paragraph 2: "The majority of WTO Members are developing countries. We seek to place their needs and interests at the heart of the Work Programme adopted in this Declaration". (See WTO, 2001a).

[6] For example, Polaski (2006) concluded in her study on the Doha Round that "agricultural liberalization alone does not benefit most developing countries or regions."

[7] The Doha Declaration on TRIPS and Public Health attempted to address the twin constraints that developing countries could face in their efforts to provide affordable medicines to their populations. The Declaration reflected the unanimity among WTO members on allowing developing countries to use compulsory licensing to promote domestic pharmaceutical production. In the case of countries that do not have a viable pharmaceutical

It is the author's opinion that, agriculture is the most significant of the sectors in need of "strategic" interventions. The agriculture sector in developing countries requires a slew of initiatives due to two sets of problems. In the first place, agriculture has faced benign neglect in the development strategies adopted by the developing countries. The second problem, one that has arisen as developing countries have embraced the trade liberalization agenda set by WTO, is the perceived threat to domestic production from subsidized products originating in the developed countries.

Developing countries need to address the above-mentioned issues through "strategic" interventions while enumerating their policy options. It is argued here that the discord in the market for technology requires governments and their related agencies to play a proactive role in promoting research and development (R&D). On the other hand, the policy-induced distortions in agricultural markets would have to be neutralised by the use of appropriate instruments that would allow countries with significant agricultural populations to protect the livelihoods of their farming communities. The two forms of interventions mentioned above are briefly discussed below.

1. Public funding of research and development

In a seminal paper published in 1959, Arrow argued that markets would underinvest in basic R&D, since production of knowledge suffers from all three conditions that would typically result in market failure. This argument became the strongest justification for the use of government funds for R&D activities in the technologically advanced countries. In recent years, several of those countries displayed significant buoyancy in the deployment of public funds towards R&D. For example, in the United States, federal R&D expenditures increased by nearly 50 per cent during 1995-2003 (Rubestein and Shoemaker, 2006).

Developing countries need to emulate their counterparts in the developed world by providing state funding for R&D for at least two compelling reasons. In the first instance, R&D initiatives taken by the developing countries would provide momentum to the process of economic growth by improving the productivity of their enterprises. This would occur as those countries would be able to successfully assimilate and adapt technologies that they might acquire from the developed world. The second, and undoubtedly the more significant of the reasons for undertaking R&D, is the fact that the strengthening of intellectual property rights following the adoption of the WTO Agreement on TRIPS made access to technologies more onerous than in the past (Federal Trade Commission, 2003).

Several studies have pointed out that the strengthening of intellectual property protection has resulted in increased control over knowledge, information and culture by a small number of very large corporations, often operating in highly concentrated markets (David and Foray, 2003). Furthermore, the protection of intellectual property has, in recent years, moved from a defensive to an offensive corporate strategy; this includes deterring the entry of potential rivals, as patents and copyrights are increasingly seen as a unique means of generating value from intangible assets (UNCTAD, 2007).

industry, it was decided that a mechanism would be developed for them to import pharmaceutical products. The TRIPS Agreement was amended in December 2005 to provide such a mechanism. (See WTO, 2001b and 2005)

Public spending on R&D should essentially contribute towards the development of institutions in addition to providing critical support for human resources development. However, the strategies for conducting R&D must be evolved through an interactive process involving the private sector.

2. 'Strategic' interventions in agriculture

Theorists had long supported the use of trade interventionist policies, but only as a means of countering specific forms of market distortions.[8] However, the advent of strategic trade theory changed that view. Strategic trade theory takes on board the reality of imperfect competition that characterizes the markets in which trade takes place. Based on this understanding, the strategic trade theorists have analysed various situations in which government intervention can be justified.

The original idea of strategic trade theory was propounded by Brander and Spencer (1984)[9] who showed that government intervention could raise national welfare by shifting oligopoly rents from foreign to domestic firms. They argued that the granting of export subsidies would have a deterrent effect on foreign exports, resulting in the profits of the home firm rising by more than the amount of the subsidy. This would result in higher home income.

During the past two decades, a large body of literature has emerged based on the foundations laid by the strategic trade theory. The major contribution of those studies has been the amount of analytical insights that they have provided into the functioning of the various sectors (largely in the context of the United States) in which interventions of the type that this variant of trade theory has tried to conceptualize.[10] These studies have assessed the potential gains from using strategic trade policies and have reached a consensus that carefully designed tariffs or subsidies can improve upon free trade in certain markets. However, at the same time, the studies emphasized the point that the findings should in no way be interpreted as general support for pro-interventionist policies.

Although available studies indicate that the use of the strategic trade theory is more of an exception, reality appears to be at considerable variance with this point of view. During the past several decades, governments in the developed world (especially the United States and the European Union) have, de facto, used strategic trade theory to maintain their domination over the global markets for major agricultural commodities.[11] The instrumentalities for using the strategic trade theory were provided by the farm policies that both the United States and the European Union member countries had been adopting without being subjected to multilateral discipline since the 1950s.[12] For example, the farm policy

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[8] See Bhagwati and Ramaswami, 1963.

[9] See also Krugman (ed.), 2000.

[10] For a comprehensive survey see Brander, 1995.

[11] While the United States and the European Union control nearly 50 per cent of wheat exports, the United States has a share in excess of 50 per cent of exports of soybeans and maize.

[12] Although the United States has, since the 1930s, been using its farm policy to provide a strategic advantage to its farm sector, it only received legal sanction to use the farm policy instruments after the GATT Contracting Parties agreed to grant a waiver from the application of Articles II and XI of the GATT (see GATT, 1955). In 1957, the Treaty of Rome (known more widely as the Treaty Establishing the European Economic Community) established the basis of the Common Agricultural Policy that has directed agricultural policy of the European Union members.

instruments are aimed at managing output in markets that have often suffered because supplies have far exceeded what the markets can carry.

Farm subsidies granted by the United States, in particular, have also led to an increase in concentration in the markets for major agricultural commodities.[13] The Food and Agriculture Organization of the United Nations (FAO, 2003), reported that the phenomenon of horizontal integration, wherein a relatively small number of firms effectively control a given market, was rife in the agricultural markets. According to FAO, horizontal concentration increases the market power of the dominant firms, enabling them to secure excessive profits.[14]

The use of policy instruments by the United States and the European Union to improve their advantage in the global agricultural market has resulted in an interesting debate in the context of the reshaping of the global agricultural policies in which WTO is currently engaged. Initiated by the developing countries, this debate makes the point that the persistence of distortions in the global agricultural market requires “strategic” interventions on their part. These interventions, they have argued, are necessary in meeting key concerns related to food security as well as safeguarding the livelihoods of the multitude of marginal farmers that dot the agricultural landscape in their countries.

Importantly, the viewpoint of the developing countries on the need to make “strategic” interventions in agriculture has, of late, found broad acceptance among the WTO member countries. These countries have been in agreement that the developing countries need to impose higher levels of tariffs on “special products”, i.e., products that are vital to the protection of food security and livelihoods. It has also been agreed that developing countries would have access to a “Special Safeguard Mechanism”, an additional instrument that would help insulate developing country producers from the threat of sudden import surges.

It may be argued that the policy framework for agriculture that is emerging through the WTO negotiations will yield positive results for agriculture in developing countries. Agriculture in those countries has had to contend with a development bias that has adversely affected the performance of this sector. The development bias has manifested itself in at least two ways. First, historically, developing countries adopted policies with regard to agriculture that resulted in the sector being taxed.[15] This resulted from the fact that the focus of such policies was on realizing policy objectives such as the attainment of food security and, in particular, providing the population with basic food items at affordable prices. Consequently, agricultural producers were unable to realize efficiency prices for the products. Thus, while developed country producers received a helping hand from their governments in competing

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[13] A Cato Institute study conducted in 1999 gave an account of how the Archer Daniels Midland Corporation (ADM), one of the major players in the grains market, had been the most prominent recipient of “corporate welfare” in recent United States history. (For details, see Bovard, 1995.)

[14] In providing evidence of this phenomenon of market concentration, FAO reported that 60 per cent of terminal grain handling facilities was owned by four companies – Cargill, Cenex Harvest States, ADM and General Mills. Some 82 per cent of corn exporting is concentrated among three companies – Cargill, ADM and Zen Noh. Beef packing is dominated by an 81 per cent share held by four companies – Tyson, ConAgra, Cargill and Farmland Nation. A total of 61 per cent of flour milling capacity is owned by four companies – ADM, ConAgra, Cargill and General Mills.

[15] Krueger and others (1991) provided evidence from 18 countries that had taxed agriculture relative to other sectors.

in the global marketplace, agricultural producers in developing countries had to contend with the disadvantage of being taxed.

A second dimension of the agricultural development bias against developing countries emanated from the fact that the industrial sector in those countries had received large doses of protection for long periods. The policy of import substitution pursued by a large number of developing countries provided a basis for protecting the industrial sector (Baldwin, 2003). The policy bias against agriculture created by import substituting industrialization in the developing countries was reflected in the tardy deployment of a relatively scarce resource, i.e., capital. India stands out as a case in point. In the early 1980s, the share of agriculture in gross capital formation in the country was close to 20 per cent, but which by the turn of the century had declined to a mere 6 per cent. Quite clearly, therefore, agriculture in India has been affected by domestic distortions, caused largely by the inherent domestic policy bias against the sector.

Binswanger and Deininger (1997) noted that the policy bias against agriculture was also evident from the lack of appropriate institutions and, more importantly, the syndrome of "missing or incomplete markets". They argued that subsistence orientation, reliance on family labour, and the use of land and cattle (or other assets) as savings instruments could be explained as being the consequence of the absence or poor development of markets for products, labour, finance and risk diffusion. Furthermore, where markets are not well-integrated, as is the case with a large majority of developing countries, factor and output prices can vary considerably in response to shocks such as drought, leading to distress sales of assets at very low prices. Such sales leave the seller with insufficient resources to purchase the assets back later when prices return to normal (Binswanger and Deininger, 1997). However, despite the long-standing debates, these conditions have persisted in developing country agriculture primarily due to the slow pace of domestic reforms (World Bank, 2007). Given such conditions, it may seem desirable to shield agriculture in developing countries, and especially crops that support a sizeable section of the resource poor producers, from the pass-through of volatile international prices[16] until the domestic reforms start yielding results. Thus, a time-bound and targeted policy of border protection can provide the trigger a turn-around for agriculture in developing countries.

E. Conclusion

Trade and investment liberalization has created immense competitive challenges for most developing countries. The challenges, in the author's view, can be met by two sets of initiatives that these countries must take if they are to have any chance of avoiding negative implications of the liberalization process. In the first place, they would need to hone their domestic productive forces by designing an appropriate policy framework that reflects the needs of all sectors. In the past, several developing countries have introduced domestic

[16] The price trends for rice and wheat in the international market between September 2007 and August 2008 give an indication of the swings that the prices of these two major cereals could witness in the future. The rice price (5 per cent broken, milled white rice), for example, increased by 207 per cent until it peaked in April 2008. Since then, the price has fallen by more than 27 per cent. In fact, one-half of the price increase in nominal terms witnessed during the surge period has been wiped out in the subsequent four months from May 2008. Wheat prices, on the other hand, increased by more than 70 per cent from September 2007 to March 2008, only to decline thereafter by more than a quarter from its peak. In the case of wheat, 62 per cent of the increase has been wiped out during the subsequent five months from April 2008.

policy distortions by displaying an overarching bias towards one sector. This policy framework has often worked to the detriment of the many countries since, more often than not, the neglected sector has been agriculture. As a result, developing countries, particularly those with large rural populations, are now faced with a formidable challenge in helping this sector to “catch up” with the rest of the world

This policy framework would need to focus on the factors that would help improve domestic efficiencies as well as create the conditions for the development of technologies. The latter assumes particular importance in the light of the fact that, in most major markets, trade barriers in the form of standards are proliferating, thus causing significant market access impediments. Second, developing countries would to protect their activities, and especially agriculture, to prevent market distortions affecting their economies. This paper is a preliminary attempt to elaborate on the two strategies discussed above.

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