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What strategies are viable for developing countries today? The World Trade Organization and the shrinking of 'development space'¹

Robert Hunter Wade

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ABSTRACT

The world is currently experiencing a surge of international regulations aimed at limiting the development policy options of developing country governments. Of the three big agreements coming out of the Uruguay Round – on investment measures (TRIMS), trade in services (GATS), and intellectual property rights (TRIPS) – the first two limit the authority of developing country governments to constrain the choices of companies operating in their territory, while the third requires the governments to enforce rigorous property rights of foreign (generally Western) firms. Together the agreements make comprehensively illegal many of the industrial policy instruments used in the successful East Asian developers to nurture their own industrial and technological capacities and are likely to lock in the position of Western countries at the top of the world hierarchy of wealth. The paper describes how the three agreements constitute a modern version of Friedrich List's 'kicking away the ladder'. It then outlines some needed changes in the way we think about development and in the role of multilateral organizations. It concludes that the practical prospects for change along these lines are slender, but not negligible.

KEYWORDS

Developmental prospects; trade agreements; property rights; articulated economies; World Trade Organization; Western dominance.

INTRODUCTION

Developing countries today, as a group, are being ever more tightly constrained in their national development strategies by proliferating regulations formulated and enforced by international organizations.

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These regulations are not about limiting *companies'* options, as 'regulation' normally connotes; rather, they are about limiting the options of developing country governments to constrain the options of companies operating or hoping to operate within their borders. In effect, the new regulations are designed to expand the options of developed country firms to enter and exit markets more easily, with fewer restrictions and obligations, and to lock-in their appropriation of technological rents.

Developed country governments, led by the US and the UK,² are driving this proliferation of international market-opening and technology-protecting regulations, using multilateral economic organizations, international treaties and bilateral agreements. They have come together to legitimize a level of intrusion into the economies and politics of developing countries hitherto frowned upon by the international community, framing the intrusion in the shape of international agreements. Ironically in view of the common belief that globalization is weakening the power of states to regulate, they are requiring developing country governments to regulate – themselves and their national firms – more, not less. At the same time, the US and the EU have not followed through on their general commitments to improve market access for developing countries.³ Both have kept large parts of their economies off the negotiating table.⁴

The net result is that the 'development space' for diversification and upgrading policies in developing countries is being shrunk behind the rhetorical commitment to universal liberalization and privatization. The rules being written into multilateral and bilateral agreements actively prevent developing countries from pursuing the kinds of industrial and technology policies adopted by the newly developed countries of East Asia, and by the older developed countries when they were developing, policies aimed at accelerating the 'internal' articulation of the economy (about which more below). At the same time, developed country tariff escalation in sectors of interest to developing country exporters limits their export growth and their rise up the value chain.⁵

All this constitutes a shrinkage not only of development space, but also of 'self-determination' space. It ties the hands of developing country governments 'forever' to *the North's interpretation* of a market opening agenda ('you open your markets and remove restrictions on incoming investment, in return for [promises of] improved access to our markets'). Here I shall show how the main international agreements from the Uruguay Round – TRIPS, TRIMS and GATS – systematically tip the playing field against developing countries. The agreements do not do for developing countries what their sponsors, the G7 states, say they will do, and they do help to lock in the economic, political and military dominance of these and other states in the core of the world economy.

Why does this matter? Partly for moral reasons. I describe a system in which bargains are struck between strong players and weak players. They each need – or see advantage in having – the cooperation of the others, so they reach agreements. But to the extent that bargaining is steered by morality, the balance of advantage in the agreements depends on which of two moralities prevails. One is the a-bit-better-than-the-jungle morality of ‘tit-for-tat’, or reciprocity, which sanctions that the agreements reflect relative bargaining strengths; thus the strong do best. The second is the all-men-are-brothers morality, which says that the strong have a duty to restrain themselves to help the weaker. This is the morality behind the decision of early twentieth century British judges to give trade unions legal privileges in order to force a degree of restraint on the part of employers. In what follows I bring out the extent to which the recent round of WTO agreements on intellectual property, investment, and trade in services expresses the a-bit-better-than-the-jungle morality, and show the implications of applying the all-men-are-brothers morality.

But the basis for not accepting the present agreements is not only moral. The case for ‘development space’ also rests on the costs to the world, including the citizens of the prosperous democracies, of making the creation of dynamic capitalisms in the non-core zone of the world economy even more difficult than it has been to date. The fear of the social instability caused by the unrestrained power of employers over employees drove the decision of those early twentieth-century British judges to choose the second morality over the first. Developed world policy makers would do well to keep this precedent in mind. Globalization erodes the insulation of the North from the responses to poverty, inequality and subordination in the South – including migration, imploding states, civil wars, religious fundamentalism and destruction of symbols of domination.

SHRINKING THE DEVELOPMENT SPACE 1: THE TRIPS AGREEMENT

The Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS) was forged in the course of the Uruguay Round (1986–94), and entered into operation in 1994. ⁶ It covers protection of trademarks, copyrights, industrial designs, data secrets, and patents (on drugs, electronic and mechanical devices, etc.). The big two are copyrights and patents. The agreement seems innocent enough. Under patents, all it does is to oblige WTO members to introduce minimum standards for intellectual property protection, and it provides a dispute resolution and enforcement mechanism. The minimum standards include: limits on states’ abilities to *deny* patents to certain types of products; a period of 20 years for all patents (many countries granted patents for shorter periods); and limits on states’

flexibility in the use of technologies or products patented in their territory, including states' ability to insist on compulsory licensing.⁷ The agreement handicaps developing countries through both economic and political mechanisms.

TRIPS economic handicaps

The economic handicaps operate through the market for knowledge. The North is a net producer of patentable knowledge, the South a net consumer. Even in the case of Mexico, an advanced developing country and member of the OECD, domestic residents made only 389 patent applications in 1996, compared to over 30,000 from foreign residents (World Bank, 2002: 136). TRIPS raises the price of patentable knowledge to consumers and so raises the flow of rents from South to North. According to World Bank estimates, US companies would pocket an additional net \$19 billion a year in royalties from full application of TRIPS. They own many patents in many countries required to tighten intellectual property protection, while TRIPS does not require tightening of US patent law.

TRIPS defenders say that the higher returns to knowledge generation in the North will yield even more innovation which will diffuse to the South. There is no credible evidence that this is the case (Helpman, 1993). In the case of copyright, tougher copyright protections raise the cost of scientific publications. Research libraries around the world paid out 66 percent more for scientific monographs in 2001 than they did in 1986 and got 9 percent fewer monographs for their money, and paid out 210 percent more for 5 percent fewer periodicals. These price escalations widen the North–South gap in access to scientific knowledge.

But it is not just a matter of the rising cost of knowledge in relation to the not-rising ability to pay of the South. It is also that as most natural science research is being privatised, less and less research is being done on issues from which the researchers and right holders are unlikely to receive a significant economic pay-off. This includes many problem areas of primary interest to populations in developing countries.

TRIPS political handicaps

The political handicaps operate through two main mechanisms. First, *developing countries' rights and developed countries' obligations are unenforceable*, while developing countries' obligations and developed countries' rights are enforceable. On paper, the rights and obligations of members look to be balanced between patent-holding (developed) and patent-using (developing) countries. In practice the agreement is skewed in favour of the developed countries, because of the difference in enforceability.

For example, the developing countries have a wide array of obligations

about what they allow to be patented and how they treat and enforce patents. If they do not meet their obligations they may be taken to the dispute settlement mechanism (DSM) of the WTO. The developed countries supposedly have obligations too, directed at ensuring that their governments and firms do provide technology to developing countries. But the agreement gives no recourse: nothing happens if they do not meet their obligations. No developing country has taken a developed country to the dispute settlement mechanism for not transferring technology. Why not? Because the costs of mounting a case are high for a developing country, the US and the EU may threaten reprisals, and the obligations of developed countries with regard to technology transfer and everything else are vague.⁸

The second political mechanism is *the use of the TRIPS' standards by the US and EU as merely the starting point for negotiating even tougher 'TRIPS-plus' standards of patent protection in bilateral trade and investment treaties* (although the agreement's minimum standards are themselves typically much tougher in favour of patent holders than developing countries had in place before the agreement).⁹ This will give the developing countries even less protection under TRIPS than they have already.

Developing country representatives have argued for years that TRIPS must be revisited. The response from the US and EU has been, 'We are happy to renegotiate, but there can be no change between [a favourite phrase] *the balance of rights and obligations struck in the Uruguay Round.*' This is a good wheeze – because the developed countries effectively placed themselves under no obligations in the TRIPS agreement. Indeed, the US has been active in trying to re-open the TRIPS negotiations – so as to secure even stronger protections for intellectual property. But in the face of developing country resistance it has recently abandoned this strategy, and is relying more on tighter enforcement of the existing rules: making more use of the threat to take a country through the WTO dispute resolution process; more use of TRIPS review procedures to press countries to enforce intellectual property rules; more use of informal bilateral pressure, including threats to withdraw aid and to support rival states in geopolitical disputes, complaints to ministries or prime ministers about unconstructive or 'aggressive' ambassadors in Geneva, and sweet deals for those who cooperate;¹⁰ more intensive monitoring of countries under the US's Super 301 trade sanctions process; and more use of bilateral and regional trade negotiations to require countries to implement even stronger national intellectual property legislation than called for by TRIPS.

Tightening the noose: Doha and Brazil

Were the negotiations over TRIPS at the Doha Ministerial meeting of the WTO, in 2001, not intended to improve the position of developing countries? The Doha Declaration on 'TRIPS and Public Health' is widely

understood to have modified TRIPS sufficiently to improve developing countries' access to certain drugs. To this extent it could expand – if developed countries deliver on their promise – developing countries' TRIPS-consistent options in a *humanitarian* direction. But it does not expand their options in industrial transformation.

Even after the Doha modifications TRIPS leaves in place a much more restrictive environment for technology transfer than the older industrialized countries enjoyed during the early stages of industrialization and the new industrialized countries of East Asia enjoyed during theirs. Recall that Japan, Taiwan, and South Korea were each known as 'the counterfeit capital' of the world in their time.¹¹ And the US in the nineteenth century, then a rapidly industrializing country, was known – to Charles Dickens, among many other aggrieved foreign authors – as a bold pirate of intellectual property.¹² In all these cases foreign firms had little legal redress against patent- or copyright-infringers in those countries of the kind that they did have against infringers at home. But today, reverse-engineering, imitation, and many strategies of innovation to develop technology are either outlawed or made significantly more difficult by the high level of patent and copyright protection mandated by TRIPS. Thus, TRIPS raises significant development obstacles for many countries that the earlier developers did not face. These issues were not on the table at Doha.

The nub of the issue is caught in a recent pharmaceuticals dispute between the US and Brazil (which resembles the 1980s dispute between the US and Brazil over computers). Brazil has taken the lead among developing countries in developing domestic capacity to produce HIV/AIDS drugs at low cost. It has thereby helped to avoid a catastrophe on the scale afflicting many African and Asian countries. Brazil's efforts have generated controversy regarding its intellectual property law. The government has relied on two particular articles of its 1997 industrial property law to advance the fulfilment of its national health objectives. Article 71 authorizes compulsory licences in the case of national health emergencies – it allows the government to authorize local producers to produce generic drugs needed to fight a national health emergency or to import from a generic producer elsewhere, despite patent protection. This article is generally understood to be consistent with TRIPS. While Brazil has not actually used this law to issue a compulsory licence, it has frequently used the threat of a compulsory licence to facilitate fairer negotiations with pharmaceutical companies regarding the terms of licencing to Brazilian companies and the prices of drugs in Brazil.

The Brazilian law also contains an article (Article 68) that authorizes licences when manufactured goods are not produced locally. If a foreign company has obtained a patent for a product or process in Brazil but does not establish local production within three years the law authorizes the Brazilian government to licence local producers to produce the good (the

term of art here is 'local working'). This is the 'industrial policy' article, with application far beyond pharmaceuticals. By spurring foreign firms to establish local production it contributes to a more developmental foreign investment regime. But it is arguably in violation of TRIPS, and has been strongly opposed by the US.

The US brought a WTO panel dispute against Brazil in 2000. In June 2001 the two countries signed a communiqué announcing the withdrawal of the US challenge, but they also affirmed that the fundamental conflict over Article 68 remains unresolved. The US threatens that if the Brazilians use Article 68 to issue a compulsory licence for non-pharmaceutical products (as part of a wider industrial policy) the WTO case would be restarted. The signal sent to other developing countries is that emulating Brazil's programme for distributing AIDS medicines is acceptable, but emulating Brazil's efforts to use intellectual property rights policy as a tool of industrial strategy is not acceptable. This demonstrates the point made earlier, that expanded opportunities for TRIPS-consistent developing country action secured at Doha are for humanitarian relief, not industrial transformation.

SHRINKING THE DEVELOPMENT SPACE 2: THE TRIMS AGREEMENT

The Agreement on Trade-related Investment Measures (TRIMS), another product of the Uruguay Round, limits the development space of developing countries even more than TRIPS, because it covers a broader swathe of their economic activity.¹³ The central point about TRIMS is that it moves trade rules from the principle of 'avoid discrimination' between countries (the 'most favored nation' principle of the old General Agreement on Trade and Tariffs), to 'avoid trade and investment distortions'. It interprets most 'performance requirements' on foreign firms as distortions, and bans or aspires to ban them.¹⁴

The TRIMS agreement bans performance requirements related to local content, trade balancing, export requirements, and it also bans requirements on public agencies to procure goods from local suppliers. A country that tries to impose such requirements can be taken to the Dispute Settlement Mechanism, and will surely lose the case. In theory the complainant (normally the US or the EU) has to provide *evidence* that the specific requirement is distorting, but in practice the US and the EU do not; they simply assert that such requirements are distorting *by definition*, and – being dominant actors – their assertions generally prevail.

Moreover the US and the EU want to modify the current TRIMS agreement so as to ban *all* performance requirements, including for joint venturing, technology transfer, and research and development. At the Doha Ministerial meeting of the WTO in 2001 the US and the EU pressed

this agenda, but India and Brazil prevented the ban being approved. However, the language in the relevant part of the current TRIMS is not legally clear, and many developing countries fear that if they do use such non-banned performance requirements the US or the EU will still threaten to take them to the DSM – whose rulings, they have seen, are almost always in favour of the most restrictive interpretation of allowable performance requirements; and the threat to take them to the DSM may well be reinforced by other threats, such as to cut foreign aid, as noted earlier. What is more, states currently negotiating to join the WTO (the ‘accession countries’) are finding that the rules they are being asked to sign on to are even more restrictive than those for existing members. There is not a standard set of rules.

TRIMS defenders point to the exemption clauses, that allow categories of developing countries ‘special and differential treatment’. The catch is that the exemptions are defined only in terms of the *time period* for complying. The time period has to do with administrative and legal handicaps in getting up to speed on TRIMS enforcement. It has nothing to do with the time needed to nurture infant industries, nothing to do with competitiveness. In this fundamental respect the TRIMS agreement narrows the scope of ‘special and differential treatment’ allowable for developing countries, compared to the scope pre-TRIMS (Pangestu, 2002).

SHRINKING THE DEVELOPMENT SPACE 3: THE GATS AGREEMENT

The General Agreement on Trade in Services (GATS) also came out of the Uruguay Round, and has been in a new round of intensified negotiations at the WTO since 2000. GATS represents the extension of WTO rules from trade in products to trade in services – including everything from banking, to education, to rubbish collection, tourism, health delivery, water supply and sanitation. ‘Trade’ includes companies setting up in a foreign country to provide services there, so GATS is also an investment agreement. Foreign investment in services accounts for roughly half of world foreign direct investment, and developing countries have been assured that complying with GATS commitments will boost FDI inflows.

The central thrust of the GATS, as with TRIMS (but not TRIPS), is market liberalization. The articles of the agreement are a list of ways in which governments should not interfere in the market, should not place barriers in the way of service trade between countries; and should not regulate the behaviour of multinational corporations operating in their country (World Development Movement, 2002; Raghavan, 2002; Sinclair, 2002). Because the responsibility for affordable provision of public services is fundamental to a government’s responsibility to its citizens – to the whole idea of social compact between government and taxpayers – the GATS

agreement is intruding even further into domestic political economy than the other two. It makes it next to impossible for developing country governments to protect their own service industries from competition from well-established foreign firms, in the way that virtually all the successful developers have done in the past.

For example, GATS requires 'most favored nation' treatment, such that a government must treat firms from all WTO members equally.¹⁵ GATS also requires 'national treatment', such that all foreign service providers must be treated at least as well as domestic firms. They cannot be required to use local suppliers, managers or staff, unless local firms are under the same requirement. And GATS requires 'market access', which prevents a government from putting a limit on the number of service suppliers or outlets and on where they operate. All this in the name of fairness.

However, GATS has a larger exemption provision than the other two agreements. Governments can specify limitations on *some* of the commitments they make in a particular service sector, and hence wall off particular government laws or regulations from GATS. Governments list which sectors and which requirements they wish to exclude (though not all requirements can be excluded – the most favoured nation principle, for example, cannot be excluded in any sector). The presumption is that anything not on their list is subject to the full commitments. In actuality however, this exemption procedure is less than meets the eye. The exemptions have to be signalled at the beginning, because it is almost impossible for governments to get them introduced later. Yet it is also almost impossible to predict what limitations should be put on commitments in advance.

As for the promised benefits to developing countries, an UNCTAD study concludes, 'There is no empirical evidence to link any significant increase in FDI flows to developing countries with the conclusion of GATS' (UNCTAD, 2002: 172). The World Bank reports similar findings. FDI location decisions are much less sensitive to the protections of GATS than they are to factors like physical infrastructure and nests of local support services.

WHAT THESE NEW AGREEMENTS MEAN FOR DEVELOPMENT

The new agreements must be seen in the context of the norms underlying the pre-Uruguay Round regime. At that time the 'development' norm carried some weight in trade negotiations, even if mainly when it could be deployed as a tool of Cold War and post-colonial objectives. The general push towards trade liberalization was conditioned by recognition that developing countries, and particularly least developed countries, needed 'special and differentiated' (S&D) treatment by definition of their being

developing countries. The answer to the question, 'what do countries need to do (need to be permitted by international rules to do) to achieve equitable development?' was not assumed to boil down to 'liberalize' and 'integrate'. Many poor countries were allowed to maintain protection.

As noted earlier, the past decade has ushered in an era of new market access dynamics much more favourable to the developed countries. Now, in the 'globalization plus' paradigm pushed from the North, the route to development is seen to be the route of liberalization and unmediated integration into the world economy, supplemented by domestic institutional reforms to make deep integration viable. As Dani Rodrik observes, 'Global integration has become, for all practical purposes, a substitute for a development strategy' despite its 'shaky empirical ground' and the serious distortion it gives to policymakers' priorities (Rodrik, 2001).

Taken together, the three agreements greatly restrict the right of a government to carry through policies that favour the growth and technological upgrading of domestic industries and firms. The sanction is market access: a country that implemented such policies can now be legally handicapped in its access to developed country markets, and the US and EU do not even have to provide serious evidence in the Dispute Settlement Mechanism that a developing country's use of specific industrial policy instruments is 'trade distorting'. To quote Dani Rodrik again:

The rules for admission into the world economy not only reflect little awareness of development priorities, they are often completely unrelated to sensible economic principles. For instance, WTO agreements on anti-dumping, subsidies and countervailing measures, agriculture, textiles, and trade-related intellectual property rights lack any economic rationale beyond the mercantilist interests of a narrow set of powerful groups in advanced industrial countries.

(Rodrik, 2001)

With a touch of hyperbole the agreements could be called a slow motion Great Train Robbery.

HOW DO WE KNOW THAT THE AGREEMENTS ARE – ON THE WHOLE – BAD FOR DEVELOPMENT?

These agreements are bad for development for at least two reasons. One is that they are vague at points where vagueness benefits the developed countries, and precise at points where precision works against developing countries. Vagueness allows the developed countries to raise the level of threat to developing countries – threats to bring a case before the DSM and threats to take other punitive actions justified on the claim that the developing country is breaking the (vaguely defined) rules of the WTO.

The second reason concerns the gulf between the agreements'

constraints on public policies in developing countries and the public policies adopted by the successful developers (Kozul-Wright, 1995; Chang, 2002). Almost all now-developed countries went through stages of protectionist policy before the capabilities of their firms reached the point where a policy of (more or less) free trade was declared to be in the national interest. Britain was protectionist when it was trying to catch up with Holland. Germany was protectionist when it was trying to catch up with Britain. The US was protectionist when trying to catch up with Britain and Germany. Japan was protectionist for most of the twentieth century right up to the 1970s, Korea and Taiwan to the 1990s. And none of them came close to matching our criteria for 'democracy' till the late stages of their catch ups.¹⁶

Today's fast growers – including China, India and Vietnam – began their fast economic growth well before their fast trade growth and even longer before their trade liberalizations. They have constrained their trade liberalization by considerations of the capacities of domestic firms to compete against imports. But today the World Bank would be first to denounce the amount of protection in their current trade policies – if they were not growing so fast. If nothing else, their experience shows how little we understand the root causes of economic growth.

On the other hand, the development experience of Latin America and Africa over the whole of the twentieth century shows that regions that integrate into the world economy as commodity supply regions – in line with their 'comparative advantage' – and that rely on 'natural' import replacement in response to transport costs, growing skills, and shifting relative costs, are only too likely to remain stuck in the role of commodity supply regions, their level of prosperity a function of access to rich country markets and terms of trade for their commodities. When Latin American countries did go beyond 'natural' import replacement during the post-Second World War 'import substituting industrialization' decades their growth performance was in fact better by several measures than it has been during the subsequent era of liberalization and privatization.

As for the argument that the agreements benefit developing countries by raising the inflow of FDI, the share of developing countries in world FDI is small and falling (from the 1990s peak of 40 percent in 1994 to less than 20 percent in 2000), and the concentration of FDI on a very small number of developing countries remains as high as in 1980, meaning that there has been no 'evolutionary' spreading out to more and more countries (Wade, 2003). Moreover, there is no evidence that GATS has lifted the inflow, as noted earlier.

Bilateral investment treaties, which have been proliferating since the early 1990s (the US has now signed 42) take the TRIPS, TRIMS and GATS' obligations of host governments as merely the starting point. They require

the host government to lift even more restrictions on foreign firms hoping to operate in their territory, to give even more concessions, in return for better access to the US or other powerful-party market. And they establish firm-state arbitration boards, which allow a private firm to take a government to arbitration by a body dominated by private-sector adjudicators naturally sympathetic to the needs of the firm, using private contract law rather than public law, which allows damages against the government to be levied retroactively. The WTO's dispute settlement mechanism, where states deal with states under public law, looks evenly balanced by comparison.

WHY ARE DEVELOPED COUNTRY STATES PUSHING THIS AGENDA?

In the light of this evidence we should be sceptical of claims by representatives of developed countries that 'ever-freer trade and investment benefits just about everybody'. The claims are better understood in the light of Friedrich List's observations about how states with head-start advantages behave. Writing in the 1840s and generalizing from the behaviour of first Holland and then Britain in the face of manufacturing competition from elsewhere he observed:

It is a very clever common device that when anyone has attained the summit of greatness, he kicks away the ladder by which he has climbed up, in order to deprive others of the means of climbing up after him. . . . Any nation which by means of protective duties and restrictions on navigation has raised her manufacturing power and her navigation to such a degree of development that no other nation can sustain free competition with her, can do nothing wiser than to throw away these ladders of her greatness, to preach to other nations the benefits of free trade, and to declare in penitent tones that she has hitherto wandered in the paths of error, and has now for the first time succeeded in discovering the truth.

(List 1966 [1885]: 368)

Perhaps the starkest example of developed countries precluding developing countries from using an array of measures that they themselves used to protect themselves from unwanted competition is the Multi Fiber Agreement (MFA). Through the MFA, the developed countries put quotas on the import of textiles and apparel in order to protect their own employment-intensive, and therefore voter-sensitive, textile industries. Developing countries that tried to do something similar today would face serious trade sanctions under WTO rules. Moreover, even though the MFA has been abolished, Western textile and apparel markets remain heavily protected through both tariffs and quotas. And agricultural subsidies

remain infamously high. Each EU cow receives an average net subsidy of \$2.50 per day, while European wheat farmers derive half of their income from subsidies, thanks to which they are able to cripple the export prospects of rivals like Argentina, which has defaulted on its debt because it cannot export enough to keep to its repayment schedule.

The apparatus of economic analysis has been deployed to affirm that largely free and open markets work best for all – which from a Listian perspective amounts to legitimizing kicking away the ladder. But there is a odd twist. Since the 1980s much work on the frontiers of economics investigates the heterodox world of increasing returns, linkages, technological learning, oligopolistic pricing, herding behaviour, irrational exuberance and the like, which at least in principle provide justifications for governments to implement industrial policy measures and restrictions on capital flows. On the other hand, the dominant ‘structural adjustment’ prescriptions of the World Bank and the IMF assume orthodox decreasing returns, stable equilibria, and no significant non-market linkage effects. Sometimes the same economists straddle both worlds, setting aside their knowledge of the heterodox world when they deal with development policy in order to hammer home the orthodox ‘fundamentals’.

The efforts of developed country states to cement the head-start advantages of their firms through the WTO agreements have been complemented by efforts to establish open capital accounts and free capital mobility as a principle of participation in the world economy. Notwithstanding all the evidence of the huge costs that free capital mobility can inflict on developing countries, especially after the East Asian financial crisis of 1997–98 (Wade, 1998a, 1998b, 2000, 2001), IMF Managing Director Michel Camdessus said in 1999, ‘I believe it is now time for momentum to be re-established. . . . Full liberalization of capital movements should be promoted in a prudent and well-sequenced fashion . . . the liberalization of capital movements [should be made] one of the purposes of the Fund’ (Camdessus, 1999).¹⁷ US Under Secretary of Treasury John Taylor declared in 2003 that the free transfer of capital in and out of a country without delay is a ‘fundamental right’ (Taylor, 2003).

WHAT IS TO BE DONE?

The new trade and investment rules and the old techniques of legitimation – ‘preach to other nations the benefits of free trade’ – join with other features of the world system to tip the playing field even more against most developing countries. One is China’s surging manufactured exports, which are hurting exporters in most other developing countries and sending a deflationary impulse through the world economy. Another is the skill-biased immigration policies of developed countries, which erode production and governance capabilities in many developing countries.

And in a class of its own is HIV/AIDs, which is destroying lives, communities, economies and governments across Africa, South Asia and parts of East Asia, with no end in sight (Putzel, 2003).

If the world is probably not moving in the right direction, as trends in world poverty and inequality suggest, then the precautionary principle – applied to the likely costs to the world of having a large proportion of the world's population still at a small fraction of the living standards of North America and Western Europe half a century from now – suggests the need for non-market measures of intervention and for refocusing international cooperation around 'development' principles rather than 'reciprocity' and 'no distortions' principles (Wade, 2003b). Concretely, this would entail stronger one-way trade preferences for poor countries, and more legitimate scope for protection.¹⁸ This was List's central prescription for a catch-up country like Germany. 'In order to allow freedom of trade to operate naturally, the less advanced nation must first be raised *by artificial measures* to that stage of cultivation to which the English nation has been artificially elevated' (List, 1966 [1885]: 131, emphasis added).

Of course, there is plenty of evidence of import substitution going awry in Latin America, Africa, South Asia and Australasia. But this no more discredits import replacement as a principle than the failure of democracy in many developing countries discredits the principle of democracy. The policy response should be to do import replacement better, not do it less (Bruton, 1998). It is clear from post-World War II experience that protection alone is not enough. Protection has to be made part of a larger industrial strategy to nurture the capabilities of domestic firms and raise the rate of domestic investment, in the context of a private enterprise, market-based economy. And as part of this larger strategy, government-led import replacement has to go with government-encouraged export development. The East Asian experience shows that trade policy restrictions on some imports need not stop the fast growth of other imports – and hence raise the demand for foreign exchange. Trade protection, in other words, need not be 'anti trade' (Wade, 1990; 1991; Jacobs, 1984). The problem in many developing countries – in Latin America and South Asia, for example, also in the formerly heavily protected economies of Australasia – has been the absence of this larger industrial strategy and implementing organizations, and the unwillingness of the 'aid' community, including the World Bank, to help them do industrial strategy sensibly.

The standard dismissal from economists is that even if protection and other forms of industrial policy could be justified in some circumstances, developing country states do not have the capacity to implement it effectively. This response rests on an unexamined assumption about low 'state capacity' in developing countries. But ironically, the world is proceeding on the assumption, in the TRIPS agreement, that developing country states do have a considerable capacity to enforce patents and copyrights. It is not

obvious that a state that can do this would not also be able to implement effective protection and other forms of industrial policy.¹⁹

REARTICULATING 'ARTICULATION'

Today we use the word 'integration' to refer exclusively to integration into the world economy, and we assume that more integration is always good for development. One of the strangest silences of development thinking is the silence about internal integration. We should distinguish between 'external integration' and 'internal integration' (or articulation), and recognize that the development of a national economy is more about internal integration than about external integration.

An internally integrated economy has a dense set of input-output linkages between sectors (a high level of sectoral articulation between, for example, rural and urban, and consumer goods and intermediate goods), and a structure of demand such that a high proportion of domestic production is sold to domestic wage earners (a high level of social articulation between wages, consumption, and production). Export demand is not the main source of economic growth. Robust political coalitions between capitalists and employees become possible in this type of economy, because capitalists, employees and the government recognize a common interest in wages as a source of sales and economic growth, not just as a cost of production. In unarticulated economies, by contrast, wages are viewed simply as a cost, not also a source of demand. Domestic production is not well connected to domestic consumption, leaving exports as the main stimulus to economic growth. Industrial and agricultural sectors producing for foreign markets remain enclaves. This socially and sectorally unintegrated structure limits the creation of class alliances, which handicaps democratic regimes.

The key question, then, is how can developing countries create more articulated economies? The starting point is to recognize that more external integration does not automatically generate more internal integration; on the contrary, it can erode internal integration. But it is also true that more internal integration, if fostered by high and unstrategic protection, can undermine external integration, at the cost of future internal integration at higher income levels.

Development strategy has to operate in the zone where the two forms of integration reinforce rather than undermine each other. But the fact is that the issues of internal integration – including practical nuts-and-bolts issues like nurturing supply links between domestic firms and the subsidiaries of multinational corporations, and designing arrangements to protect exports from protection – have largely dropped out of the development agenda as promulgated by Western development organizations. And the WTO agreements make it much more difficult than in the past for

development strategy to capture the synergies between internal and external integration.

To put the same point in more familiar terms, today's development theory assumes that the principle of comparative advantage – specialization between countries in line with the location preferences of firms in free and competitive markets – should be the ur-principle of development policy. Conversely it assumes that the principle of import replacement – government encouragement of local production of some items currently imported – is not to be followed, because such policies have seemingly been discredited by the evidence of what happens when it guides the policy framework. In fact, the central challenge of national development strategy is to combine the principle of comparative advantage with the principle of import replacement in a way that generates pressure for upgrading and diversifying national production. This does not always imply protection. Strategic economics prescribes free trade, protection, subsidies, or some combination, depending on a country's circumstances and level of industrialization. In some sectors and at some times, a country should give little weight to import replacement and a lot to comparative advantage; and vice versa.

There are a number of small and non-growing countries which, even if untrammelled by international rules, could not hope in the foreseeable future to do more than provide a low-wage platform for rich-country outsourcing, and whose domestic markets are too small to offer more than very limited possibilities for import replacement. There are others, particularly in Latin America, where the scope for import replacement is much bigger but where rapacious oligarchs have long used import replacement policy as yet another means of monopolizing opportunities and exploiting their populations. Here, more trade liberalization and more foreign direct investment can plausibly be seen as a way to force the oligarchs to cede their control over the economy – after which it may make sense to promote another round of concerted import replacement. Meanwhile, China is currently doing both at once, aggressively exporting in line with changing comparative advantage and aggressively replacing some current imports, following in the footsteps of Japan, Korea and Taiwan.

RE-TOOLING MULTILATERAL AND REGIONAL ECONOMIC ORGANIZATIONS

A more development-friendly environment requires changes in the mandate and procedures of the multilateral economic organizations. The question is how to reconceptualize and legitimize expanded 'special and differential treatment' for developing countries and dilute requirements for 'reciprocity', 'national treatment' and 'international best practice'. The balance needs to be shifted away from the drive to homogenize trading

commitments to other states towards granting states reasonable scope to choose appropriate levels of national protection (including for health, safety, working conditions, and the environment).

More specifically, the rules of the international economic regime should allow developing countries to accelerate import replacement by measures such as tariffs and subsidies (preferably made conditional on improved performance of the assisted industries). The rules should allow developing countries to give less scope for intellectual property protection than the current TRIPS standards, and assistance in enforcing those lower standards. As a specific example of what should be changed, Article 27.1 of the TRIPS agreement says that a 'patent shall be available and patent rights enjoyable without discrimination as to . . . whether products are imported or locally produced'. Developing countries should have the right to discriminate against patent rights when – after an appropriate period of years – the product is not locally produced. This is a key to import replacement, which is a key to industrial transformation.

Furthermore, international rules need to grant countries the right to use forms of capital controls in order to maintain the stability of their economies and protect trade flows (Bhagwati and Tarullo, 2003). The standard reply from economists is that global financial markets are now much too big and digitized to be subject to any form of cross-border controls. But the regime for tracing drug money and terrorist money across borders has proven to be quite effective; which suggests that unauthorized capital movements could be subject to the same sort of penalties as tax evasion.

Economists also qualify their recommendation by saying that the capital account should be liberalized *pari passu* with 'sound' or 'prudent' regulation. But in truth we do not have good measures for judging the soundness of financial regulation. The World Bank published in April 1997 a list of countries whose capital market regulation was strong enough to safely support an open capital account. South Korea, Malaysia, Thailand 'with Indonesia and the Philippines not far behind', Chile, Mexico, 'with Brazil also ranking well' (World Bank, 1997: 59). The East Asian financial crisis began three months later.

Suppose that the IMF had the authority of its Articles of Agreement to pressure countries to open their capital accounts on a timetable that it deemed appropriate. It would almost certainly underplay the dangers to the countries, both because of our lack of knowledge of how to gauge the 'strength' of a country's system of financial regulation and because the IMF is highly attentive to the preferences of Wall Street and the City of London as mediated by the US Treasury and the UK Treasury.

Arrangements for debt-repayment standstills also have to be part of the arsenal. They would require an international organization (perhaps the IMF) being authorized to support them and the major industrial countries

recognizing the authority of the organization so that bondholders would be prevented from asserting claims in court.²⁰

The rules of the system should encourage countries to maintain a 'positively correlated' capital structure, such that the cost of borrowing is higher when ability to repay is higher and the cost is lower when ability to repay is lower. At present, developing countries tend to have 'inversely correlated' capital structures, where they borrow cheaply when times are good and borrow expensively when times are bad. This is a recipe for volatility, financial crisis, slower long-run growth, higher poverty and higher inequality (Pettis, 2001).

Finally, internationally agreed standards should be cast in terms which allow considerable leeway for national governments to interpret them. Committees of unaccountable experts, as in the WTO dispute settlement mechanism, should have limited powers to constrain the role of democratically accountable national bodies.

All these changes would give more room for different forms of national capitalisms to flourish, with the international framework designed to maximize international economic stability rather than at maximum free movement of goods and capital (Rodrik, 1998; Wade, 1996). If this sounds pie-in-the-sky, recall that the Bretton Woods system did meet these criteria and delivered magnificent economic performance through the 1950s to the 1970s.

As part of this policy-non-convergence scenario, we need to build up regional-level organizations, so that markets can be embedded not only nationally but also in regionally distinct configurations, with policy solutions tailored to the different vulnerabilities of different countries and regions. This is the point that the two Korean labour federations had in mind in their remarkable statement to US Treasury Secretary Rubin in July 1998.

The Asian development model, while containing some of the key elements which gave rise to the current crisis, also contains the very dynamic elements which made the 'miraculous' growth over such a short period. . . . The IMF policy regime, however, has overlooked . . . the positive and dynamic elements in its virtual blanket disavowal of the Asian economy. . . . It may be necessary, therefore, for Asian nations to build a body . . . which can serve as an Asian monetary fund.

(KCTU, 1998)

THE UNPROMISING POLITICS

It is easy to say that 'the international economic regime must be changed, developing countries should be given . . .'. The politics are another matter. The developed country negotiators and the 500-strong WTO staff are

being driven by a mixture of ideological conviction and intense corporate lobbying. A former WTO negotiator commented that, 'without the enormous pressure generated by the American financial services sector . . . there would have been no [GATS] services agreement'. The pressure came especially from the US Coalition of Service Industries, the European Services Forum, and the UK's Liberalisation of Trade in Services (LOTIS) group' (World Development Movement, 2002). The TRIPS agreement was propelled by a few industries – mainly pharmaceuticals, software and Hollywood – that stand to gain a lot from the protections, whose interests the US government championed. It is not obvious that agreements written to suit western pharmaceutical companies, software companies, the Motion Picture Association, and Wall Street/City of London are good for the world.²¹

On the other hand, developing country governments are not cooperating closely enough to push for the sorts of changes suggested here. For the most part their trade negotiators accept the legitimacy of the idea that 'market access' is the key to development – but they emphasize their access to the North's markets, while the North's 'market access' agenda emphasizes the North's access to their markets, presented as being in *their* own best interest. They negotiate for better market access (for their exports) as an end in itself, not for 'development space'. And they do not see the critical importance of retaining the policy option of being able to constrain the inflow and outflow of capital by means of quantitative restrictions.

The vested interests are so strong, the legitimacy of the 'globalization plus' paradigm so well defended in the centres of power, that only economic crisis is likely to shift thinking. Yet how many more crashes like those of the 1990s and the early 2000s will the world endure before we conclude that the project of constructing a single integrated world market with universal standards – the culmination of the European Enlightenment ideal – is a mistake? Many, quite likely, provided that the populations of the G7 states are not seriously affected.

But small changes are possible even outside of crisis conditions, generated by some combination of, global social movements of NGOs, companies slowly expanding their social responsibility charters, 'epistemic communities' of scholars rethinking development strategies, and developing country governments pushing quietly ahead to encourage new activities (import replacement, new exports) in ways that by-pass or go under-the-radar of the international agreements.²² From among these various entities it may be possible to organize coalitions for a determined push to revise specific and harmful clauses in existing agreements, such as Article 27.1 of TRIPS.

And now that the WTO has come to affect central aspects of people's lives around the world, we should work right now to make it more open.

At present the negotiations to create new trade agreements are opaque, and disputes about existing rules are mostly resolved in secret. Governments of developing countries are often left out of the horse-trading sessions and presented with *fait accompli*. We should press the WTO to reduce the current vagueness of the capstone agreements, which rebounds to the advantage of the developed countries; to adopt clearer operating rules and procedures; to publish a record of voting and discussions; to require the chairs of negotiating committees to explain why they include some proposals and reject others from the text of the draft declaration, rather than, as at present, being able occultly to make a 'magic text'.²³

After all, several monetary authorities, including the Bank of England and the Federal Reserve, have started to publish full minutes soon after decision-making meetings, and the experience is generally considered to be successful; and judges in many countries are required to give reasons for their decisions. We need the WTO to be subject to much closer scrutiny by NGOs, in much the way that the World Bank is watched by the Bank Information Center (BIC), an NGO based in Washington DC, and by the BrettonWoods Project, based in London.²⁴ And it would surely help if the WTO staff – which is an active policy maker, far from a mere facilitator of negotiations among representatives of member states – was more representative. Some 80 percent of the staff are nationals of developed countries, whose population comprises less than 20 percent of the population of the member states.²⁵ As what the Bush administration calls the US's 'strategic competitor', China, begins to inject its nationals into the WTO and other international organizations, and as China acquires the technological and even military capacity to be a competitor to the dominance of the west, it will be interesting to see how the international development agenda changes.

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NOTES

- 1 See also UNDP, *Making Global Trade Work for People* (London: Earthscan, 2002).
- 2 For an account of the dominance of the G7 (Group of Seven) states inside the WTO see Kwa (2002).
- 3 These commitments were made in the Uruguay Round of 1986–94, and re-made in the Doha agreement of November 2001 to start a new round of multilateral trade talks.

- 4 The US has raised its agricultural and steel subsidies since the Doha agreement, and is more likely to raise trade barriers for textiles and garments, footwear, and several farm products than to lower them. These are sectors that are vulnerable to import competition from developing countries and important for the US political support system. The EU deploys protection about as much as the US, and has flouted its Doha commitments even more blatantly than the US by failing to commit to a timetable for reducing its subsidies.
- 5 Tariff escalation refers to higher tariffs on imports of more highly processed commodities.
- 6 The section on TRIPS is co-written with Kenneth Shadlen; see Shandlin (2002).
- 7 Compulsory licensing laws allow states to sidestep patents, to insist that a firm holding a patent on a technology or product of general importance license it to other firms.
- 8 For example, the TRIPS agreement gives a precise and narrow scope for states to limit patent rights for public purposes (for example, to limit patents on community knowledge), but gives wide and vaguely-defined scope for granting private patent rights (for example, over naturally occurring micro-organisms and micro-biological processes). So a state that refuses to allow patenting of micro-organisms is liable to a complaint, whereas a state whose firms take out patents on community knowledge in another country is not.
- 9 For example, the draft bilateral treaties (such as those with Singapore, Chile, Jordan, the Free Trade Area of the Americas [FTAA] negotiating text) further reduce exceptions to patentability, further limit the other government's ability to sidestep patents with compulsory licenses, and in pharmaceuticals make the other government commit to the same provisions for easy extension of the patent beyond 20 years as in the US. The US in the FTAA negotiations is pressing for patents as the only method for protecting plant varieties.
- 10 The scope for sweet deals is enhanced by the 'single undertaking' nature of the WTO. Countries may decide that they have to accept a bad deal on some matters (e.g. TRIPS) in order to get what they want on other issues (e.g. agriculture). US appeals to the agriculture minister may elicit governmental pressure on the Geneva ambassador to give way on TRIPS.
- 11 Wade, 1990: 268–9.
- 12 Dickens was so angry about American infringement of copyright on 'A Christmas Carol' that he toured the US in 1842 urging adoption of international copyright protection in the long-term interests of American authors (Lohr, 2002). See also, Richard Kozul-Wright (1995); Ha-Joon Chang (2002).
- 13 TRIPS relates mainly to patentable or copyrightable activity.
- 14 Performance requirements cover not only obligations but also incentives for investors/producers to do certain things. For example, the government might offer a tax incentive in return for a certain proportion of 'local content', locally procured inputs. Or in return for 'trade balancing', exports worth a certain proportion of imports; or exporting a certain proportion of total production; or joint venturing with a local firm.
- 15 South Africa's awarding of telecommunication contracts to Malaysian companies on the grounds that they had experience of handling problems of racial access to telephone networks, could be challenged on most favoured nation grounds.
- 16 Hong Kong and Singapore are the great exceptions on the trade front, in that they did have free trade and they did catch up – but they are city-states and not to be treated as countries. In any case, Singapore did place performance

- requirements/incentives on foreign subsidiaries and mounted an industrial policy to provide them with needed factor inputs.
- 17 But a recent paper by IMF staff economists, including Chief Economist Kenneth Rogoff, finds no evidence that opening the capital account is good for growth and good evidence that it raises the volatility of national consumption (Prasad *et al.*, 2003).
 - 18 The effectiveness of nonreciprocal trade preferences for poor countries is suggested by Rose (2002) who finds that, contrary to general assumption, being a member of the GATT/WTO as such made no statistical difference to how much trade a country did with others, but receiving trade preferences under GATT's Generalised System of Preferences (GSP), preferences that rich countries gave to poor ones, roughly doubled a poor country's trade compared to what it would have been otherwise.
 - 19 My thanks to Ken Shadlen for this point.
 - 20 For more radical proposals see D'Arista (2000); Wade (2000b); , Idem., (2002b).
 - 21 See Aileen Kwa, 'Power politics in the WTO', 2002.
 - 22 Korea and Taiwan beefed up covert trade controls even as they announced bold trade liberalizations.
 - 23 A South Asian delegate said about the process of formulating the Draft Declaration for Doha, 'In the process of negotiations, we would object to a text, but it would still appear. We would state we wanted a text added in, and still it would not appear. It was like a magic text'. Quoted in Kwa (2002: 21).
 - 24 A small WTO-watching NGO called the International Center for Trade and Sustainable Development (ICTSD) already exists, now in its sixth year. It publishes a regular bulletin of WTO news of particular interest to developing countries, Bridges. Others include WTO WATCH, Our World Is Not For Sale Network, Third World Network, the Trade Information Project which focus on getting information to NGOs and social movements to enable them to engage in advocacy with their governments and with the WTO. On WTO openness see 'Open up the WTO', editorial, The Washington Post, reprinted in International Herald Tribune, 23 December 2002. For a different view see Walter (2001). On international organizations more generally see Woods (2003). For UK-based NGOs' opposition to a new investment agreement at the WTO see Oxfam (2003).
 - 25 Kwa (2002: 43).

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