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TRADE POLICY AS DEVELOPMENT POLICY: BUILDING ON FIFTY YEARS' EXPERIENCE

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TRADE POLICY AS DEVELOPMENT POLICY: BUILDING ON FIFTY YEARS' EXPERIENCE*

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* The views expressed in this paper are those of the author and do not necessarily reflect the views of the UNCTAD secretariat.

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Executive Summary

Despite 50 years' of debate, international trade continues to be one of the main areas of development policy. I offer a brief account of how openness came to be the generally preferred policy stance, and analyse a number of remaining trade issues for the new millennium.

The advocacy of import substitution as a route to development arose naturally from the intellectual and practical policy-making environment after the Second World War. Big government apparently worked (and bureaucrats knew how to plan), manufacturing was equated with development and required planning, and foreign exchange had to be conserved for necessary imports of capital equipment by economizing on all other imports. In time, this view fell apart. Economic theory showed that trade policy was not an appropriate response to most market failures, open economies overtook closed ones in performance, and import substituting trade regimes were shown to be rife with huge, arbitrary and costly distortions. Moreover, once it was realized that political capture rendered it very difficult to make effective and unbiased interventions, policy advice veered towards market-friendly and non-interventionist positions. Such positions have not completely dominated the debate, however, because, as well as traditional protectionist sentiments, such policies raise genuine concerns about equity and because we do not fully understand how openness contributes to economic growth.

For the future, I argue that openness and non-discrimination should remain our watchwords. Not only does openness boost economic efficiency and, on the balance of the evidence, economic growth, but simple and open trade regimes aid good governance. They reduce the opportunities for discretionary policy, and hence for corruption and arbitrariness, and they offer a way of conserving skilled labour for the many other challenges of development, such as education and efficient administration. I argue that countries should embrace vigorous trade liberalization packages, albeit with suitable transitional periods, that trade policy should address barriers, such as poor customs formalities, infrastructure and tariffs, and that liberalization should be multilateral and not regional in nature. Concern for equity should be pursued by explicit redistribution.

A key factor in the ascendancy of open trade policies in the 1970s was measurement, which showed the indefensible state of trade regimes under import substitution. Our current inability to measure and summarize trade regimes lies at the heart of the difficulty of proving conclusively that openness is good for economic growth. For the next decade an UNCTAD that devises and produces effective measures of trade regimes would make a huge contribution and more than measure up to the complaints of its critics: "An UNCTAD that measures, measures up!"

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TRADE POLICY AS DEVELOPMENT POLICY: BUILDING ON FIFTY YEARS' EXPERIENCE

L. Alan Winters[*]

INTRODUCTION

International trade continues to be one of the main areas of policy controversy for developing countries. Some see protection from the cold winds of competition as an essential part of the early stages of development, while others see protection as creating, rather than curing, problems in developing economies. This debate has continued over the last 50 years, and although current thinking is closer to the liberal end of the spectrum than it used to be, controversy is very far from over.

This paper was written in response to an invitation from the UNCTAD Secretary-General to take a brief personal look at the course of thinking on trade policy since 1950, at the processes by which views have evolved and at the agenda for UNCTAD and similar organizations over the next decade or so. It is brief and personal and makes no pretence towards comprehensiveness. I stress the way in which more open policies have come to dominate import substitution in policy advice and urge that, in the future, openness and non-discrimination remain our watchwords. I concede, however, that the objective empirical evidence in favour of this view is not as strong as one might hope after 50 years of research. I base my advocacy of openness not only on arguments about economic efficiency and growth, but also on the belief that simple and open trade regimes offer a means of reducing governance problems in developing countries: they reduce the opportunities for discretionary policy, and hence for corruption and arbitrariness, and they offer a way of conserving skilled labour, in both public and private sectors, for the many other challenges of development such as education, efficient administration, entrepreneurship and research.

I argue that a key factor in the ascendancy of more open trade policies was measurement. The collection of data and their sensible presentation in the 1970s showed the parlous and indefensible state of most developing countries' trade regimes under import substitution. I also argue that our inability to measure and summarize trade regimes lies at the heart of our inability to prove conclusively that openness is good for economic growth. For the next decade, an

[*] I am grateful to J. Michael Finger and Adrian Wood for comments on the outline of this paper, and to colleagues on the Round Table on UNCTAD X for comments on an earlier draft. The paper would doubtless have been better if I had accepted all their good advice. I am also grateful to Beatrice Harrison for logistical help.

UNCTAD that devises and produces effective measures of trade regimes would make a huge contribution and more than measure up to the complaints of its critics: "An UNCTAD that measures, measures up!"

I. LOOKING BACK

In this section, I offer a stylized history of post-war thinking on trade policy, as summarized in table 1. The aim is to identify both the trends in thinking about trade policy as development policy and the intellectual and experiential factors that lay behind them. I recognize that real life was both more complex and messier than my account, but I am trying, first, to be brief and, second, to highlight what I believe to be the major story-line behind these events. The major challenge of producing a historical account of policy thinking is to avoid a mere *ex post* rationalization of the trends. Economic research is diverse enough that one can always find an intellectual precursor to any change in policy views, but that does not answer the question of whether the precursor was influential, and, if it was, why it happened to be preferred among the alternatives available at that particular time. Thus, I urge the reader not to take the history in too simplistic a cause-and-effect way. I have also added at the end of the section a few comments about the other forces that underpinned the major shifts in policy advice.

Throughout this paper, I focus exclusively on developing countries' own trade policies. I do not deny that other countries' (specifically industrial countries') policies have some effect on growth and development; but they are not the main factor. Despite facing a more or less common trading environment, developing countries have had fundamentally different development experiences, from which I conclude that country-specific factors dominate. Once one recognizes that most countries are economically small, simple economic theory also suggests that countries' own trade policies dominate global factors in their development.[1]

A. The story so far: policy[2]

Table 1 distinguishes, perhaps a little arbitrarily, between theories of macro-policy and those based on the economics of resource allocation. The former are the big issues, such as what fosters development, and deal quite explicitly with the whole economy. The latter encompass both macro- and micro-economic issues. They are macro to the extent that they draw on the fundamental insights of general equilibrium analysis. This is one of economists' unique contributions to the policy-making process and an *indispensable* component of trade policy thinking because comparative advantage is a general equilibrium concept. Resource allocation

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[1] In the World Bank I coined the acronym WYDIWYG (What you do is what you get) to remind people of this message.

[2] This section draws on Anne Krueger's (1997) brilliant essay on much the same subject, which I strongly recommend to interested readers. Other recent accounts of the same material include Rodrik (1992), Nayyar (1997) and Bruton (1998).

Table 1

A stylized history of post-war thinking on trade policy as development policy

Decade	*Macro policy*	*Resource allocation*
1950s	Import substitution Commodity pessimism and industrialization; infant economy protection; special and differential treatment; regionalism	Welfare economics of trade Second best
1960s and 1970s	Export promotion	General theory of distortions Infant industry arguments Costs of protection Effective protection
1980s	Outward orientation Getting prices right; fallacy of composition; costs of adjustment	Political economy of protection Rent seeking
1990s	Endogenous growth Theory and evidence; governance Economic geography	Trade and technology Poverty/Income distribution

economics also covers micro-issues, however, such as optimal policy choice, and is the basis of the measurement of protection and its effects which, I shall argue below, underpinned the major advances in trade policy thinking.

In the beginning there were Smith and Ricardo; but by the 1950s, despite a number of brilliant disciples, such as Viner and Haberler, they were in eclipse. Several factors conspired to persuade economists that developing countries should manage their international trade very tightly. The apparent success of government intervention in the wartime economies and in Russia legitimized State management. Development was equated with industrialization, and industrialization was seen as an indivisible whole: one needed to advance over a wide range of industrial sectors simultaneously to have any chance of success, which called for considerable coordination. Further, the key to industrialization was investment, and since investment goods had to be imported from the industrialized countries, it was essential to conserve foreign exchange for that purpose. Primary commodity exports were not seen as a viable long-term source of foreign exchange because their demand prospects were limited and their terms of trade inexorably falling.

These views informed a fairly coherent policy position that import substitution (IS) was the route to development. Local industry was to be highly protected and there was a strong case for special and differential (S&D) treatment under GATT. Developing countries required both exemption from liberalization under GATT and enhanced access to industrial markets. Regional trading arrangements (RTAs) were another logical conclusion, for by increasing the size of the import-substitutes market they reduced the cost of the industrialization (Cooper and Massell, 1965).

The policy may have been internally coherent, but it was wrong. As time progressed, IS regimes became ever more arbitrary and distorted as Governments tried to micro-manage their economies. Moreover, IS was conspicuously unsuccessful in improving developing countries' trade, employment and poverty performances, and not obviously successful in stimulating economic growth. In addition, by the early 1970s, an alternative strategy based on promoting trade, rather than curtailing it, was beginning to show promise in the startling performance of the four tigers (the newly industrializing economies [NIEs] of Taiwan Province of China, the Republic of Korea, Hong Kong [China] and Singapore). I discuss briefly below what lay behind the success of these economies, but at the absolute minimum their experience showed that growth and industrialization were feasible without contemporaneous IS.[3]

A further, albeit slightly later, blow to the IS school was Balassa's (1981) demonstration that the more open NIEs weathered the oil-shocks far better than did the more closed import-substituters. This was a genuine surprise, for one of the previous claims for IS was that it offered some insulation from the excessive shocks in the world economy. Clearly, the open economies did face greater shocks, but apparently they were so much more flexible that they could withstand and recover from these better than the import substituters could cope with their smaller shocks.

The factual attack on IS was influential but it depended on, and was supplemented by, an intellectual one. The critical contribution to trade and development theory, from research in the

[3] rez argues, in a very interesting paper prepared for the UNCTAD Round Table, that IS did not so ate. When the prevailing mass-production technologies were growing fast in the 1950s and 1960s, industrial country firms were pleased to export them to nascent developing country manufactures. As the the search for efficiencies via factor costs and global sourcing turned export promotion into the successful paradigm. Interestingly, she doubts whether the information technologies of the opportunities. Hers is an attractive view, but it depends for its future usefulness on unproven regularities between successful technological revolutions. Also it is not informed by the chaos tha characterized IS regimes, which arose too rapidly and were too *ad hoc* to be explained solely by global changes.

1950s on resource allocation issues, was not the advances in the welfare analytics of international trade – for these largely reinforced the old arguments that trade was desirable in a static sense – but the theory of second-best (Lipsey and Lancaster, 1956). This offered cover for IS by using the liberalizers' own neo-classical tools to show that trade liberalization could not be guaranteed to be advantageous in an imperfect world. In the 1960s, however, second-best aspects of policy choice were refined into a general theory of distortions (e.g. based on Corden, 1957; and Bhagwati and Ramaswami, 1963), which led to rankings of policies in which trade policy was almost always nth-best.

The apex of this literature from a practical point of view was, perhaps, Robert Baldwin's (1969) dissection of the infant industry argument, which left almost no respectable case for such protection at all. In addition, the dangers of casual second-best theorizing were realized – as in Harry Johnson's (1970) wise health warning that the application of second-best economics needs first-best economists, not its usual complement of third- and fourth-raters.

Even more important in the 1960s were advances in measurement. The theory of effective protection provided a pragmatic, if theoretically inelegant, measuring rod, and pioneers, such as Bela Balassa and Ian Little, showed that distortions could be identified and quantified. The result was startling in revealing not only the chaos of most developing countries' trade regimes but also the cross-country regularities in such chaos. These regularities largely rebutted the 'excuse' that IS was acceptable in principle but had been ruined in practice by incompetent administrators.

Initially the NIEs' strategy was seen as one of export promotion (EP), which was contrasted with IS. However, it soon became obvious that no countries' net export incentives were as large as IS countries' anti-import distortions. Dispute raged, and still rages today, about whether this was because significant import restrictions were being offset by export incentives or because the policy stance was less interventionist overall. There is still, for example, disagreement about the interpretation of the East Asian experience.

Two forces led the balance of the normative argument in the 1980s, to shift (over the eighties) from the use of export promotion tools towards the non-interventionist school, which is what I mean by outward-orientation in table 1. First, there was a broad-based swing in industrial country opinion away from government action and towards letting markets work. Ironically, at least at first, this was less evident in their trade policies than elsewhere – the 1980s saw increased numbers of voluntary export restraints (VERs), tighter Multi-Fibre Arrangement (MFA) restrictions, and more anti-dumping actions – but this did not prevent such opinion from covering trade policy when these countries offered development policy advice. Second, Krueger (1974) argued that implementing policy effectively was very difficult and that rent seeking could lead to efficiency losses far exceeding the traditional losses due to resource misallocation. Krueger's was an argument for preferring tariffs over quotas and other regulations, but it was soon realized that such difficulties afflicted all policy to some extent, and even the policy-making process. Increases in the complexity and extent of intervention seemed likely to lead directly to increases in the efficiency costs of implementation, in the probability that policy makers are captured[4] by special interests, and in the waste of resources devoted to directly unproductive activities. Thus, except where there was strong evidence to the contrary, simple, transparent and predictable policies looked best.

The World Bank's writings and advice illustrated this transition clearly over the 1980s, and it became one of the strongest advocates of the simple light-handed touch. The Bank did not undertake the fundamental research for this view, but was prominent in filling in the holes, providing measurement, and thinking about its practical application. Again, measurement was critical, in which aspect the Bank was immeasurably helped by UNCTAD's pioneering work to record and categorize non-tariff barriers.

Trade liberalization featured in very many Bank (and eventually IMF) policy matrices, and since about 1987 there has been a significant reduction in trade distortions in developing countries. There have been many protests, however. Among the concerns expressed were that open borders would preclude developing countries from ever developing manufacturing sectors, that world markets could not absorb export growth from all developing countries at once, and that the costs of adjustment (political and economic) would be too large for the prospective gains.

The first of those worries is just old IS again, and while liberalization can lead to the loss of some protected manufacturing, the evidence of deindustrialization, still less of deleterious deindustrialization is not great. The second is clearly a concern for some primary goods, but as a general proposition, it neglects the fact that liberalizing countries are markets as well as suppliers. While there are likely to be adverse terms-of-trade spillovers if several similar countries liberalize together, these do not seem likely to offset the overall benefits of liberalization. Adjustment costs are a worry but one cannot put off change indefinitely. There is a case for some subtlety in the timing and sequencing of liberalization if the ultimate goal is wholly credible, but far too often delay undermines credibility, and sometimes ill-chosen transition paths worsen distortions for quite long periods.

The 'victory' for outward-orientation in the policy debate challenged even its own advocates. Casual empiricism supported the position, but pure theory was agnostic. The intellectual challenge to IS had been essentially static, whereas the problem to be solved was dynamic. The need was to establish that 'openness leads to growth' as a robust, perhaps universal, prescription, and to explain why it worked. That is, economists and policy makers needed not only to address the comparative static benefits of openness but also to analyse the path towards the static gains and the genuinely dynamic benefits if any.[5]

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4 Capture is the process by which regulators/policy makers come to identify with the sectors they are supposed to be regulating and thus begin to give undue weight to the direct interests of those sectors.

5 Economists generally think of growth in simple income terms, but other dimensions of growth, let alone development, are obviously also important. Fortunately, there is a fairly high positive correlation between the various dimensions. Moreover, to the extent that they conflict, the difficulty of making trade-offs owes more to disagreements (continued...)

Theoretical work did not help very much. The new theories of 'endogenous growth', stressing learning, knowledge and human capital, opened up new dimensions to comparative advantage – learning versus producing – and new ways in which international specialization could generate economies of scale, by eliminating redundant research efforts. But their results were mostly very fragile and far from being applied in the real world. These results frequently suggested the possibility that some countries could lose from international trade, but since it was difficult to identify empirically when a country might fall into this last class, this analysis just did not help practical policy-making. It is one thing to declare that trade policy should foster learning and the adoption of technology, but quite another to design a policy that actually does so.[6]

Empirical work to establish the growth-benefits of openness looked more promising. Initially (in the late 1980s) there was some hesitancy about whether cross-section econometrics could deliver the necessary insight, but developments among growth empiricists swept this aside. Although the 'endogenous growth' theory was technically complex and subtle, its empirical implementation became heavily dominated by simple cross-section regression methods.[7] Over the early 1990s such studies – perhaps most famously by Sachs and Warner (1995) – suggested, *prime facie*, that openness strongly enhanced growth,. These results were always somewhat contentious, especially in their definitions of openness, but in policy debate they ruled supreme. Recently, however, Rodriguez and Rodrik (1999) have formalized some of the misgivings about this research stream and, as it were, re-established the old agnosticism. While there is no evidence that openness or trade liberalization is bad for growth, the case that they are good is not completely secure either.

Recent work on economic geography, for example Krugman (1995), has parallelled some of the uncertainties of the endogenous growth literature. The knowledge externalities of the latter are replaced by agglomeration externalities in the former, and the result is again that, within certain bounds, cumulative processes can occur and some countries can lose from trade. Geography is intellectually very attractive, as it deals with real-world phenomena, such as agglomeration and growth spurts, but it has not, I believe, yet produced any practical guidance on trade policy. One of the reasons is that its results depend critically on a generalized notion of trading costs, which we are currently quite unable to measure convincingly.

At the same time, as intellectual doubt has increased about whether openness is always beneficial at a country level, interest has also revived in whether it could hurt some people within a country. This was always known to be a possibility theoretically, but practically it had been

(...continued)
about relative weights than to uncertainty about the technical relationships between the different factors.

6 My co-panelist, Deepak Nayyar, has offered a rather similar history to that in this section so far (Nayyar, 1997), but he sees it as a regrettable victory for a flawed doctrine rather than the painful struggle towards better policies.

7 The literature on 'convergence' was more sophisticated, but it has been less influential in trade policy circles than the simple growth models.

neglected over the 1980s and early 1990s. Wood (1994) deserves most of the credit for reviving the issue.

B. The lessons from history: policy-making

History has definitely taught us one huge substantive lesson: closed and tightly managed economies do not prosper. A fair degree of openness, both in terms of policies and outcomes, seems to be more or less necessary for sustained economic development. History also, I believe, helps us to understand the process whereby broad trends in policy thinking evolve – an essential exercise if we wish to influence future policy (and understand why, on occasions, we fail to do so).

The account above comprises statements about stylized facts/perceptions of the world, actual facts (taking care the two are usually distinguishable) and analytical advances. To elucidate the policy process, however, we need to add in the incentives for the various actors involved. Policy is neither designed nor analysed by disinterested automatons, but by individuals who, even behaving by the strictest professional standards, have interests and opinions. These interests and opinions do not necessarily dominate hard evidence, but they do influence the research agenda and, in the areas that evidence does not determine for us, policy decisions.

As well as being based on a series of false premises about the world and about development, import substitution also received strong backing from two particular constituencies. First, the Second World War had allowed manufacturing to emerge in a number of peripheral economies, and they would undoubtedly have felt considerable pressure if the re-establishment of traditional manufacturing supplies had not been attenuated by protection. The importance of industrial elites in these countries made IS politically very powerful. Second, and more contentiously, planning was what official economists and bureaucrats knew how to do. They had little incentive to challenge conventional wisdom.[8]

Academic economists did not offer much of a challenge either. Of the several reasons advanced by Krueger for this, the most significant is their failure to operationalize either their positive or negative results. Thus, for example, it is hard to disagree that a positive dynamic externality provides a case for temporary intervention (e.g. infant industry assistance). But to be useful we need tools to detect and quantify the externality and to know when it has run its course; that is, we need to know which infants will grow up healthy and repay their keep, and which to strangle at birth. Similarly, a major modality for trade theory research was to provide reasons why unrestrained trade based on comparative advantage was not guaranteed to be optimal. Although there was nothing wrong with that intellectually, these papers frequently gave succour to those intent on overruling comparative advantage for quite different reasons. It would have been better had their authors more carefully noted their arguments' limitations, delimited their areas of

[8] Carlota Perez also argues that IS suited industrial country firms – see footnote 3 above.

application, and spelt out *operational* conditions for identifying when their results were likely to be beneficial.

Perhaps unfortunately, academic criteria do not encourage either operationalization or modesty about the scope of applicability of results. Rather the emphasis is on elegance and surprise. An example of the policy dangers inherent in these relativities is strategic trade policy, which was elegant, surprising, exciting and, at first, fun. Its applicability was never going to be particularly great – especially to developing countries – and after a few years its leading exponents (e.g. Paul Krugman and Avinash Dixit) abandoned it as a practical tool. However, it still fills lesser journals and figures in discussions with policy makers.

Parallel to operationalization is *measurement.* Measurement was, perhaps, the key antidote to IS, and this is a very important lesson. The economics profession undervalues measurement (measurers) relative to theory (theorists), and is weaker for that. I believe that the major barrier to understanding the links between openness and growth is the measurement one – our inability to characterize trade regimes adequately due to failures in both data collection and analysis. One of the features of the cross-section literature referred to above is a tendency to treat openness as a dichotomous variable – you are either open or closed. In fact, however, while there is probably a threshold above which trade policy can be thought of as ‘closed’ (e.g. Democratic People’s Republic of Korea), and another below which such policy can be considered ‘open’ (e.g. Hong Kong, China), there is also a middle range in which ‘openness’ is ordinal or even cardinal. At present we are nowhere near being able to identify these thresholds or discuss degrees of openness satisfactorily.

One of the derivatives of the IS view was the case for special and differential treatment for developing countries under GATT. From relatively minor beginnings, this assumed a dynamic of its own over the 1950s and 1960s, in which offering export preferences to developing countries and releasing them from the various disciplines on import policy was driven by politics and rhetoric rather than economic analysis. GATT disciplines were seen as a cost to member Governments, and waiving them was a simple and cheap way of purchasing developing country participation in GATT and the Western economic system. This dynamic was reinforced by the rivalry between GATT and UNCTAD, the latter of which turned degrees of bias in favour of developing countries into almost the only politically correct yardstick for measuring trade liberalization (see Finger, 1991). This experience re-inforces two lessons, in my mind: first, you cannot divorce policy from politics, but the latter can emphasize and develop quite unimportant aspects of the former. Second, measurement is king. In this case, as Finger argues, the measurement was inappropriate, but its influence on the debate was undeniable.

Policy-making has a good deal of inertia. I have already noted that IS was attractive to incumbent policy makers and it is evident from the record that it took a long time to overcome this effect. More recently, one might detect a similar effect in trade negotiations. The large trade bureaucracies built up to handle the Tokyo Round needed something to do over the early 1980s. They pressed for further trade talks and also helped make trade an issue in areas such as development policy. Since the Uruguay Round these bureaucracies have had a similar effect, as well as turning their hands to regional trade agreements. Geoff Raby, Australian Ambassador to the WTO, argues that this 'making work for idle hands' is a major factor behind regionalism in the 1990s. The lessons here are that policy messages are far more likely to succeed if there is a ready-made machine for implementing them, and that it is best to have useful things ready for bureaucracies to do.

II. LOOKING FORWARD

I want also to consider the future of trade and trade policy. In this section I pose five questions/issues that seem likely to be important over the next decade, and sketch some tentative answers where I have them. I conclude with some thoughts about what all this means for UNCTAD.

Five key policy questions

(i) Can we identify non-neutral interventions in international trade that accelerate development? And can we prevent their capture?

This question is carefully phrased: it is not 'are there' interventions, but can we 'identify' them. There are undoubtedly hundreds of individual cases where a one-off policy intervention would be beneficial, for example, where protection would allow learning or training, or generate a terms-of-trade gain, or support a poor family while it learned new skills. But these opportunities are mostly far beyond our grasp for three sets of reasons.

First, we do not generally have the information required to identify the opportunity effectively. The difficulty is not usually in seeing that something is going wrong, but in saying why it is going wrong and in showing that trade and related interventions will cure it. For example, if the cost of training labour penalizes prospective manufacturing firms, will protection increase their incentive to train workers, or reduce it by increasing the rate at which new firms would enter the sector and bid labour away from the leader? Agricultural protection may raise prices, but it will not raise the return to agricultural labour or small farmers if the effect is wholly capitalized into land prices and rent. Moreover, it is important to realize that policy is relative. It is not only necessary to ask whether someone benefits from an intervention, but also whether they will benefit more than they might under an alternative policy, and whether they benefit more than the losers lose. Protecting automobile manufactures may help firms and workers in that sector, but consumers and other users (frequently other firms) will lose through higher prices, and other producers will lose via higher wages for skilled workers. Skilled workers in automobile manufacturing may generate some spill-over effects on learning and on unskilled workers, but they may have generated even more had they remained in small-scale undistorted manufacturing service activity.

Second, the processes whereby interventions are translated into behaviour and outcomes often depend on quite subtle parameters, which are not amenable to observation, especially for hard-pressed developing country Governments. This immediately puts the policy process at the mercy of interested parties. It is not only rank dishonesty that leads to capture but also an insidious process of information-sharing and norm-creation. Moreover, as I noted above (see footnote 4), capture is possible not only by the sector but by the policy-making bureaucracy as well. Recent years have seen a welcome surge of practical and academic interest in governance, and current opinion locates governance failure at the heart of the development challenge. Robust, simple and non-discretionary policies are far better than the opposite for encouraging clean administration, because they offer fewer opportunities for corruption and fewer distractions for the monitors. In addition, less distorting policies generally offer lower returns to corruption than do more distorting ones. From these perspectives, the advantages of a low uniform tariff over a high and finely graduated one seem huge.

Third, there are systematic aspects to intervention. Sufficient effort might overcome the information and the governance problems of an interventionist trade policy, but it is costly. Moreover, by signalling a willingness to intervene, one is encouraging petitions for interventions: the mere act of establishing the public and private institutions necessary to examine trade interventions objectively perpetrates a flow of requests for intervention that absorbs labour that would be better employed otherwise. Moreover, institutions cause inertia, so that the game continues even after the conditions that may once have justified it have changed – consider the European agricultural bureaucracy, for example. In other words, effective intervention, even if possible (which I doubt), is likely to be very costly and may just not be worth it.

These strictures about trade policy apply in some other areas of government as well, for example industrial policy, but they are not a case ‘against government’. There are myriad tasks for government – health, education, infrastructure, legal structures, customs administration, etc. That these other tasks are so critical is yet a further reason why Governments should eschew trade intervention.

Even in an account as brief as this, one cannot discuss trade policy and development without mentioning East Asia. The key exhibits are the Republic of Korea and Taiwan Province of China. They undoubtedly had intervention, although, as noted above, it was relatively neutral between exports and imports overall, and they clearly developed rapidly.[9] There were special features to their policy stances. For example, the focus on exports provided discipline on firms, a yardstick for policy, and constraints on excessive distortion elsewhere in the economy; also the policy-making environment permitted the rapid correction of policy mistakes. These countries also had very strong performance in other policy areas such as education and infrastructure. It is interesting that Lee (1995) finds that trade interventions impeded productivity growth in the Republic of Korea (while tax intervention aided it). I am not sure we have really got to the bottom of the East Asian story yet, but I do think that experience elsewhere suggests that it is an Asian rather than a universal story.

[9] Hong Kong (China) and Singapore were more liberal initially, as were the second-wave economies, when they took off.

It is sometimes argued that advocates of openness promote allocative efficiency at the expense of technical efficiency (e.g. Nayyar, 1997). The evidence that openness directly boosts technical efficiency in middle-income countries is not particularly strong. However, its indirect effect is significant in terms of allowing efficient firms to expand, and policies which discourage firm turnover (e.g. tailor-made protection for incumbents) will reduce the rate of technical advance (Roberts and Tybout, 1996). Moreover, Bigsten et al. (1998) show that in low-income Africa technical efficiency in manufacturing is enhanced by openness.

Finally, it is necessary to ask whether optimal trade intervention varies by country. If one believes that development equates with manufacturing, one might argue for distinguishing by comparative advantage, because comparative advantage will lead some countries away from that sector. I do not believe this view, however. Small isolated economies, or those that are rich in resources or have high internal transactions costs, as in Africa, are unlikely to develop major manufacturing bases; however, some subsectors will still be open to them for local and, possibly, for particular export markets. Moreover, a decent living can be made outside manufacturing, as in New Zealand and Chile; and there is no evidence that a coddled manufacturing sector will improve on that living.

Another school of thought suggests distinguishing by stage of development, arguing that very poor countries need different stances in their policies on trade from other countries. This takes us to the second question.

(ii) Are there preconditions for benefiting from trade liberalization? Are there necessary concomitant policies?

My general answer to this question is that, while some conditions clearly help, there are no absolute preconditions. It is quite clear that trading infrastructure – hard and soft – greatly facilitates exporters and importers taking advantage of open borders. And if it is not in place, developing this infrastructure is, I believe, a necessary concomitant. But even if the infra-structure is not in place, liberalization is likely to open up some opportunities, and to postpone liberalization would be to forego these opportunities. Only if the holes in the infra-structure are severely biased, so that trade will develop contrary to long-term comparative advantage (an unlikely condition), or if a slow start will irredeemably damage the political conditions for liberalization, would I suggest waiting.

The problem with most delays is that they cast doubt over the eventual policy reform itself and thus hinder, rather than assist, evolution towards an appropriate policy constellation. If one waits until everything is 'right' for trade reform, one waits indefinitely. Once the final destination is credibly established (by political action, possibly aided by bindings at WTO or commitments to the Bretton Woods institutions), my personal view is that transition periods can be quite long. Such gradualism would permit putting in place the various legal and institutional reforms that help to maximize the benefits of liberalization and the smoothing over of any cyclical hindrances to liberalization. The key condition, however, is that the eventual liberalization be quite assured. It is interesting that some trade reforms, which initially generated great resistance and could be negotiated only with recourse to long transition periods, have actually been speeded up once the adjustment has started – for example, the Kennedy Round and internal free trade in the European Economic Community. Presumably once the destination is clear, economic actors prefer to get on with it.

The success of outward-oriented policies in East Asia followed periods of import substitution and were accompanied by huge steps in education and training. Are these preconditions or concomitants for trade liberalization? In East Asia, which has a strong comparative advantage in manufacturing, this portfolio of policies worked well, but that does not necessarily make it applicable to other countries.

Education is essential to development quite independently by trade policy, and hence is not really covered by this debate. The question of whether a preceding period of import substitution is necessary for trade liberalization to be successful is more complex, however. To one extent or another, nearly all countries have developed their export industries out of those already supplying domestic markets. Amsden (forthcoming) argues eloquently that among industrial economies and those constituting her ‘rest’ (broadly speaking a set of well-established middle-income economies) only Switzerland and Hong Kong (China) used free trade as a catch-up strategy. And she lists an impressive number of cases in which exports have grown from domestic industries.

History has been unkind to us in resolving this dilemma, as import substitution was a more or less universal creed over the 1950s and 1960s. Thus, just as successful episodes have emerged from it, so have unsuccessful ones. Moreover, the practical issue is not so much whether exports grow out of domestic sales – they almost always do, for very few entrepreneurs set up purely exporting operations in new industries – but whether exports grow out of highly protected domestic sales. Amsden argues that the key difference between successful and unsuccessful industrialization strategies is the ability of Governments to extract exports out of protected domestic industries.[10] I would argue that low levels of protection can help that process. I would also argue that an open low-income developing country is likely to have a real exchange rate so low that manufacturing will emerge to serve domestic markets from which, if comparative advantage dictates, exports can develop. Moreover, building up a manufacturing sector that will not have comparative advantage is not an obviously useful strategy. It creates lobbies for continuing protection and will have to undergo significant change when liberalization occurs. I argued above that industrialization and development are not synonymous, and so I am rather unsympathetic to building up this sector before liberalizing.

In very poor countries, trade taxes are an important source of revenue. Creating alternatives, including excise taxes, is a concomitant policy, but again I would not delay liberalizing until those alternatives are introduced. Nearly all protection structures can be reformed

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[10] Relatedly, Roberts and Tybout (1996) show that export booms typically rely heavily on existing domestic firms starting to export.

without loss of revenue if they switch non-tariff barriers (NTBs) into tariffs, unify rates (ideally to a single level) and abolish exceptions.

(iii) Is non-discrimination passé?

My answer here is unambiguously 'no'. Unilateral preferences – much beloved by UNCTAD and many developing country policy makers – have not, in general, been a success (Wang and Winters, 1997). In most goods the margins are small because industrial country tariffs are low. Where they are not small, the preferences are constrained either quantitatively (formally or informally) or by rules of origin. Where developing countries have comparative advantage, they frequently have no preferences at all – for example, the United States' general system of preferences (GSP) excludes clothing. In the few cases where preference margins are significant, they are no basis for investment and development because they are insecure. Focus on preferences teaches developing country negotiators to choose short-term quasi-rents rather than to focus on long-term needs, and opens them up to pressure on unrelated issues such as labour standards.

I am similarly sceptical about regional trading arrangements (RTAs) for developing countries. There are undoubtedly cases where North-South arrangements have delivered benefits to developing countries, such as Portugal and, I believe, Mexico, but these have been cases of middle-income countries joining very close and much richer neighbours. For most developing countries, RTAs seem likely to be a distraction from devising suitable development policies based on the world market; they seem as likely to produce trade diversion as trade creation; and they seem unlikely to do anything for economic growth (see Winters, 1997; Vamvakidis, 1998). Regional trading arrangements can figure as a route to non-discriminatory trade liberalization, for example by creating coalitions for more general reforms. But research suggests that they are just as likely to thwart movements in that direction (Winters, 1999c).

The danger of the world splitting into a few trading blocs is not immediate, but neither is it completely absent. Such a development would be deleterious for developing countries, which would almost inevitably have to identify with one bloc or another. This would probably be costly in terms of trade diversion and the distortion of their production patterns to fit into the bloc overall. It would also have political costs, as dependence on a single metropolis would erode their bargaining power (McLaren, 1997).

(iv) What about vulnerable groups?

Trade policy is strongly redistributive, and almost any change is bound to create both winners and losers. We tend to forget that existing policy has already influenced current income distribution and to discuss reform in terms of those whom it hurts. There is undoubtedly a moral and political case for concern if policy change suddenly undercuts particular families, but it is important to ask whether the status quo is the correct benchmark for the long term. Import substitution typically benefits urban capital owners, urban workers and bureaucrats, and some rebalancing in favour of other groups may well be desirable.

In the real world, the distributive consequences of trade reform can be quite subtle and surprising, depending on very particular details of local conditions. Winters (1999a, 1999b) discusses the various factors linking trade and poverty in more detail, and describes some field research from a project supported by the United Kingdom's Department for International Development (DFID). This suggested that trade and associated reforms in India and in countries in Africa have a capacity to help alleviate poverty by allowing the poor to sell their produce or their labour on better terms. It also suggested, however, that markets could collapse and disappear under certain circumstances, with serious consequences for poverty. An example was the way in which remote farmers in Zambia lost the ability to sell their maize when the State marketing board (which had cross-subsidized rural collection) was replaced by private trading firms. This suggested to us that reform should be accompanied by careful monitoring and remedial action to ensure that markets function competitively and efficiently when trade liberalization occurs.

The adverse effect of trade liberalization on poverty is sometimes advanced as a reason for not reforming. I do not accept this, although timing may be something to consider in this light – for example, not liberalizing a labour-intensive sector in the middle of a slump. First, as I have hinted above, one needs to think hard about the *net effects* of reform on poverty and income distribution. Merely identifying some losers – even poor losers – is not sufficient to condemn a policy. Since trade reform usually stimulates growth, the usual case will be that liberalization will help the war on poverty.

The correct approach, then, is to think in terms of compensatory policies. Specific compensation in the form of trade adjustment assistance has been tried, not least in the United States, where it has had mixed success. It is probably not as effective as general anti-poverty compensation policies, such as public works and food-for-school programmes. These treat poverty directly and avoid the tortuous business of identifying whether a problem is due to trade reform or not. Also, they are not generally particularly distortionary because they affect only people who have virtually no alternative. Poverty programmes can be very useful for alleviating poverty, and thus are certainly concomitants of trade liberalization, where poverty impacts might be a problem. They are not, however, suitable for addressing adverse shocks higher up the income distribution. There, general unemployment and training programmes are required.

It is not useful to pretend that no one gets hurt by trade reform. On the other hand, one clearly cannot allow reform programmes to become hostage to a few losers. The correct approach, it seems to me, lies in policies that ease adjustment in general, possibly supplemented by temporary trade-reform-specific programmes if there is a widespread view that trade reform will throw up uniquely difficult problems.

(v) Is trade policy critical to development?

Trade policy continues to be a real issue. There are undoubtedly other equally important policies for development, such as education, health, infrastructure and macroeconomic management, but a bad trade policy is likely to stymie development efforts. A very restrictive trade policy probably permits other policies to get further out of line (Krueger, 1990), and if trade policy is arbitrary and interventionist it poisons the whole Government/business relationship.[11]

To refine the answer a little, the evidence is quite strong, if actually rather informal, that trade is important to development. The less secure link is whether trade policy matters for trade. At the extremes, it clearly does consider the Democratic People's Republic of Korea, the EU's Common Agricultural Policy, etc. The issue is at what stage policy falls into the 'acceptable' range, and here, I believe, we are largely at sea because we cannot measure trade regimes adequately.

The problem is not only in collecting and summarizing information on formal barriers, but in capturing the subtler aspects, such as how reliably tariffs are collected, how frequently changes are made, how sensitive those changes are to lobbying and how accessible and distortionary safety-valve protection is. Clarity, predictability and the absence of official discretion are probably just as important as whether the tariff is 5 per cent or 15 per cent.

Related to this is 'trade policy' in a broader sense, covering trade facilitation issues such as customs administration; and support services such as banking, insurance, communication and transportation, and port efficiency. These are more difficult to reform than mere tariff rates, but are probably becoming more important as tariffs fall and global supply chains come to dominate production and trade. Moreover, these are the issues to which recent work on endogenous growth and economic geography relates industrial location and take-off. Interpreted in this way, trade policy moves right back to centre stage.

I conclude that trade policy is a real issue. Even if its traditional concerns are not sufficient to ensure development, getting them right is an important first step towards that goal, and an indication of serious intent on the other broader front. Reforming trade infrastructure will only be worth the effort if the traditional instruments are liberal enough to permit meaningful trade volumes and sufficient competition to ensure that lower trading costs get passed on to consumers.

III. LESSONS FOR UNCTAD: POLICY-MAKING

Finally, I ask what does all this imply for UNCTAD and its trade activities?

A dominant message from this paper is the importance of *measurement*. This plays to a major strength of UNCTAD with its inventories of trade barriers in its Trade Analysis and Information System (TRAINS), and I would urge that this is the area for future focus. No other body has shown the ability to assemble trade policy data. The WTO has the means, but cannot divorce data collection from the negotiating/political aspect of its work, which makes it an

[11] Even if the parties concerned are hooked on the poison and do not realize it.

extremely unreliable source of data for analysis.[12] UNCTAD can place itself at the centre of the whole of this debate by devoting resources to collecting, verifying and publishing trade policy and trade data.

Relatedly, UNCTAD should undertake and promote other agencies and researchers' efforts to collect data on other trade frictions. These include regulatory restrictions in areas such as environment, procurement and services, as well as costs in the areas I identified under trade facilitation above. Again UNCTAD has a track record in some of this – for example, on environmental regulations and the World Bank-UNCTAD programme on Expansion in Foreign Direct Investment and Trade in Services (EFDITS) – but the need for additional information is almost unbounded. Moreover, there is scope for significant analytical work in devising appropriate measurement methods and analytical summaries for these data.

On policy, UNCTAD has perhaps become identified with a view sympathetic to trade intervention. Too often, however, this appears to be based on possibilities, or on refutations of the generalizations made elsewhere in favour of the market. Krueger's (1997) plea for operationalization is key here. We should stress the need to delineate the area over which a policy recommendation applies, with clear ways of identifying when we have moved outside the limits. Honest delineation will (on all sides) leave us with many grey areas where we just do not know what policy is appropriate, but a rush to colonize these areas with rhetoric is neither edifying for an international organization nor, ultimately, useful.

Related to this delineation is honesty about how well we understand our advice. International organizations and donors – not least my former employers, the World Bank – frequently talk about 'best practice'. For long-term objectives like development, this raises serious questions of how we know what is best. Some clarity on this would be welcome. Most of what we say will, at best, be provisional.

There is always a fear that if policy advice is not bold, confident and comprehensive, it will just leave the field open for policy makers to pick-and-mix a pseudo-scientific justification for what they wanted to do anyway. Of course, it is for politicians/policy makers to decide; but if analysts are to avoid being misrepresented, we need to be more prepared than heretofore to point out the consequences, the surprising correlates (such as which firms benefit from a policy), and the false premises of actual policy. This runs the risk of conflict with Governments; the 'owners' of international organizations. However, if the approach is applied even-handedly, most of the Governments that resent comment on their own affairs will, nonetheless, accept it as a price for greater clarity and discipline on others' affairs.

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[12] The data from WTO are reliable in themselves, and indeed the WTO criticizes UNCTAD's for being less so. The problem is that *access* to WTO data is unreliable.

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