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WTO Report Card III

Globalization and Developing Countries

by Aaron Lukas

Executive Summary

The "anti-globalization coalition" that paraded through the streets of Seattle in November and stormed police barricades in Washington, D.C., in April contends that international trade and investment are "lose-lose" propositions. On the one hand, organized labor argues that low-wage workers in developing countries will gain employment at the expense of American workers. On the other hand, self-appointed advocates of the developing world claim that trade with and investment from Western countries lead only to exploitation and continued poverty abroad. Given that negative view of globalization, it is not surprising that anti-trade activists are calling to "shrink or sink" the World Trade Organization.

The two previous Cato "WTO Report Cards" demonstrated that open markets have been a boon for the thriving U.S. economy and that the rules governing world trade do not infringe on U.S. sovereignty. This third paper examines the other side of the equation: the effect of trade and investment liberalization on the world's poorer nations. According to the prevailing anti-trade line, developing countries suffer from a "race to the bottom" in abusive labor practices, environmental quality, and wages. Sweatshops and child labor, not economic opportunity, are the supposed consequences of free trade. In reality, however, the empirical experience with foreign trade and investment in the developing world has been overwhelmingly positive. From rising wages to improved working conditions, the competition and cooperation that accompany liberalization are proving to be powerful forces for good. Moreover, the claim that developing countries were somehow bullied or tricked into opening their markets is simply false; the pace of economic liberalization has accelerated because poor countries have realized that liberalization is in their best interest.

In the half century since the founding of the General Agreement on Tariffs and Trade, the world economy has grown 6-fold, in part because trade has expanded 16-fold. Globalization has improved and will continue to measurably improve the lives of millions of people around the world.

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Empirical research supports the link between the freedom to conduct international transactions and economic growth.

Trade, Growth, and Development

> Millions of workers are losing out in a global economy that disrupts traditional economies and weakens the ability of their governments to assist them.
>
> —Jay Mazur, president,
> Union of Needletrades,
> Industrial and Textile Employees[1]

The essential prerequisite of a "globalized" economy is openness to foreign trade and investment. This means that a country's citizens must be free to buy and sell goods or services in the international marketplace, unburdened by excessive tariffs or other trade barriers. It also means that foreign businesses and investors must be allowed to purchase and own property in the local economy and that their investments must enjoy standard legal protections.

Developing countries embrace globalization for a variety of reasons. The removal of trade barriers immediately expands the range of choices for consumers and places downward pressure on prices, thus raising the real value of workers' earnings. Foreign investment provides more jobs, new production technologies, infrastructure improvements, and a source of capital for local entrepreneurs. Domestic businesses gain access to both cheaper inputs and vastly larger markets for their products. But for most people, the many and varied benefits of a liberal trade and investment regime can be boiled down to one very attractive proposition: globalization spurs economic growth, and growth raises living standards.

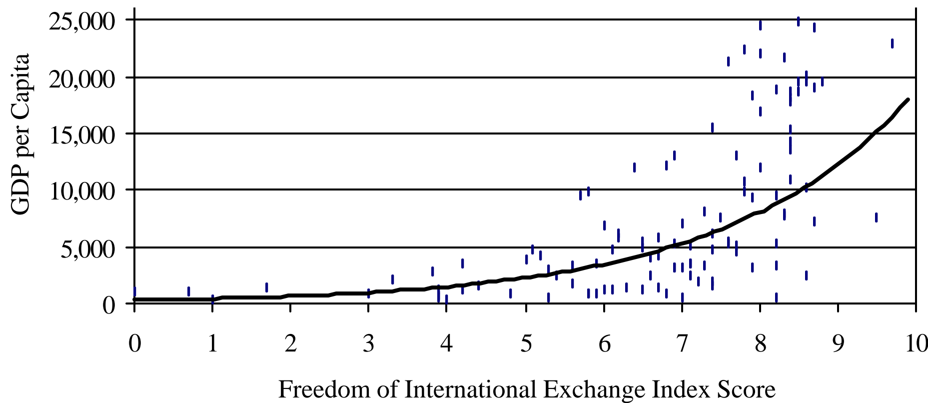
Empirical research supports the link between the freedom to conduct international transactions and economic growth. A well-known paper by Jeffrey Sachs and Andrew Warner of Harvard University, for example, found that developing countries with open economies grew by an average of 4.5 percent per year in the 1970s and 1980s while those with closed economies grew by only 0.7 percent.[2] The same pattern held for developed countries: those with open economies grew by 2.3 percent per year while those with closed economies grew by 0.7 percent.[3] Other studies, such as a 1998 analysis by the Organization for Economic Cooperation and Development concluded that nations with relatively open trade regimes grow roughly twice as fast as do those with relatively closed regimes.[4] Obviously, developing countries that grew at the open-economy average have been converging with the industrial economies while their closed-economy counterparts have tended to fall further behind.

One of the broadest measures of economic openness is found in the *Economic Freedom of the World: 2000 Annual Report,* by James Gwartney, chief economist of the Joint Economic Committee, and Robert Lawson of Capital University.[5] *Economic Freedom* ranks countries, in addition to other areas, on their relative openness to international exchange. The report ranks countries on a scale from 0 to 10 on the basis of such factors as mean tariff rate, taxes on international trade as a percentage of exports plus imports, nontariff barriers, and total size of trade sector. As Figure 1 shows, there is a clear correlation between per capita gross domestic product and openness to international trade and investment as measured by Gwartney and Lawson.

Critics of cross-country comparisons correctly point out that isolating the effects of trade liberalization from those of other variables is methodologically daunting, since reductions in trade barriers are frequently made in conjunction with a host of other reforms. Two points, however, are crystal clear. First, there is an undeniable relationship between growth rates and economic freedom, including the freedom to conduct international transactions. Second, contrary to the claims of the anti-trade forces, there is no evidence whatsoever that countries that have shut themselves off from global markets have prospered over the long term.

Perhaps the strongest evidence of the benefits of economic liberalization is that developing countries over the past couple of decades have been opening their markets voluntarily, independent of any quid pro quo negotiations. Countries as diverse as Argentina, the

Figure 1
Freedom of International Exchange Index and GDP, 1995



Sources: James Gwartney and Robert Lawson, *Economic Freedom of the World: 2000 Annual Report* (Vancouver, B.C.: Fraser Institute, 2000); and the *World Almanac 1998* (New York: World Almanac, 1998).

Note: Although Gwartney and Lawson provide an index of international exchange openness for 1997, the data beyond 1995 are incomplete.

Philippines, Chile, and Thailand have taken aggressive unilateral steps toward integration into the global economy. Even the most traditionally closed economies are finally abandoning the failed autarkic model of protectionism in favor of freer trade. Over just the past few years, India has reduced its average industrial tariffs from 71 to 32 percent, Brazil from 41 to 27 percent, and Venezuela from 50 to 31 percent.[6] The World Trade Organization's own history illustrates the "bottom-up" popularity of trade liberalization. Established in 1948, the General Agreement on Tariffs and Trade—the precursor to the WTO—had only 23 contracting parties, most of which were industrialized nations. Today, more than three-quarters of the WTO's 136 members are developing nations and 20 more are eagerly waiting to join.[7]

The Asian "Miracle": Exports and Investment

The experience of East Asia is one reason for the current trend toward economic openness among developing countries. Perhaps more clearly than anywhere else in the world, East Asia has demonstrated the rapid improvement in human welfare that is possible when developing nations adopt an outward-oriented development strategy. Real per capita incomes in the region have grown at an average annual rate of 4 to 6 percent since the 1960s.[8] That compares extremely favorably with development experience elsewhere: from 1960 to 1990, the top eight Asian economies grew approximately three times faster than did the economies of Latin America and South Asia and five times faster than those of sub-Saharan Africa.[9] Moreover, as Table 1 shows, the recent Asian financial crisis appears to have presented only a temporary obstacle to those burgeoning economies. Even if the crisis had stopped all economic progress for five years, the Asian economies would have performed well above the world average for the past three decades.

Such robust economic growth has translated into dramatically improved standards of living that are readily observable to anyone visiting the region. South Korea in the 1960s, for example, was comparable to many West African countries

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Table 1
Changes in Real GDP in East Asia (in percentage)

	1996	1997	1998	1999E
South Korea	6.8	5.0	–5.8	10.2
Malaysia	8.6	7.5	–7.5	4.9
Thailand	5.5	–1.3	–10.0	4.0
Indonesia	8.0	4.5	–13.7	0.5
Hong Kong	4.5	5.3	–5.1	1.9
Singapore	7.5	9.0	0.3	5.5
Taiwan	5.7	6.8	4.8	5.4
China	9.6	8.8	7.8	7.1

Source: World Bank and independent forecasts, cited in Eduardo Lachica, "World Bank Predicts Improvement in Asia," *Asian Wall Street Journal,* February 8, 2000, p. 3.

Note: E = Estimate.

in terms of economic development. Today its citizens enjoy incomes on a par with those in European countries. Tiny Singapore, which has few natural resources, has transformed itself into a trade and technology powerhouse. In China, per capita GDP has nearly quadrupled in just 20 years. As a result, an estimated 160 million people in China have emerged from absolute poverty, defined as per capita income below $1 per day.[11] Since 1970, per capita food intake in Indonesia has risen from fewer than 2,100 to more than 2,800 calories per day.[11] In 1972, nearly 68 million Indonesians were living in what their government deemed poverty; by 1982, that number had fallen to 30 million—a decline of 56 percent.[12] Up and down the Pacific Rim, active engagement in world markets and an openness to foreign investment have wrought breathtaking improvements in the lives of hundreds of millions of people.

The success of the East Asian economic "miracle" rests on two basic factors: export-friendly policies and access to foreign markets.

The East Asian economic "miracle" is not difficult to comprehend. Its success rests on two basic factors: export-friendly policies and access to foreign markets. By contrast, many developing countries in other regions pursued policies of "import substitution," which entailed sealing off their economies from the outside world with import restrictions, maintaining overvalued exchange rates, shunning foreign investment capital, and fostering industries to serve domestic markets. East Asian countries followed a very different path. Although the exact policy mix differed from country to country, the common denominator was an emphasis on growth through competing in world markets. Specializing in industries in which lower labor costs gave them a competitive advantage, East Asian economies opened to foreign capital, technology, and the inputs necessary to produce competitive exports for sale to foreign customers. That strategy enabled the Asian economies to grow much faster than if their prospects had been limited to domestic demand.

The export-led growth strategy was a stunning success. As a group, the eight highest-performing Asian economies increased their share of world exports from 8 percent in 1965 to 13 percent in 1980 and to 18 percent in 1990.[13] Initially, that export-led growth was compatible with the significant protectionism in those economies but led eventually to greater demand for imports—both producer goods for expanding businesses and consumer goods for emerging middle classes—and tariffs were cut in response. The pattern of greater openness of the East Asian economies is reflected in their ratios of trade to GDP—the value of exports plus imports divided by GDP (Table 2).

The recent financial crisis in Asia has not

Table 2
Ratio of Trade to GDP in East Asian Economies, 1970–88

Economy	1970	1980	1985	1988
Hong Kong	1.50	1.52	1.78	2.82
Indonesia	0.25	0.46	0.38	0.42
South Korea	0.32	0.63	0.66	0.66
Malaysia	0.89	1.00	0.85	1.09
Singapore	2.12	3.70	2.77	3.47
Taiwan	0.53	0.95	0.82	0.90
Thailand	0.28	0.49	0.44	0.35

Source: World Bank, *The East Asian Miracle: Economic Growth and Public Policy* (Oxford: Oxford University Press, 1993).

prompted a retreat from economic liberalization. On the contrary, Asian governments have realized that to keep prosperity going they must continue to open their economies to world trade and investment. In a story typical of the region, the government of Thailand successfully resisted protectionist pressures despite a severe recession—real GDP dropped nearly 12 percent between 1997 and 1998—that resulted from the crisis. "One of the most striking aspects of the [Thai] government's policy response to the crisis," notes a WTO report, "is its liberalization of several aspects of its trade and foreign investment regime in order to speed up structural adjustment."[14]

The East Asian experience contrasts sharply with that of sub-Saharan Africa, which has largely pursued a development strategy based on protectionism and foreign aid. Most of Africa's so-called infant industries have never developed, the region's share of world trade remains distressingly low, and GDP per capita actually shrank by 0.6 percent between 1991 and 1998.[15] In addition to maintaining closed economies, many African countries have used foreign aid to underwrite unsound policies and general economic mismanagement, including the creation of bloated, inefficient public sectors; the restriction of prices and production; perverse monetary, fiscal, and credit policies; and the shunning of foreign investment. The combination of foreign aid and isolation from international competition has thus allowed many African governments to postpone implementing necessary market reforms, thereby trapping their citizens in a never-ending cycle of poverty.

The lesson is clear: export-led growth has a proven record of success, while its alternative—protectionism and foreign aid—has failed where it has been tried. The question is, will the rest of the developing world be allowed to repeat the Asian miracle? If other developing countries are to re-create the Asian experience, they must have relatively free access to U.S. and Western markets. If Americans want to help the impoverished masses of the developing world, we must open our markets to its exports and allow U.S. investors to invest overseas.

It is no coincidence that economic growth has been accompanied by beneficial political changes in many developing countries, including those in East Asia. Both South Korea and Taiwan, for example, began to implement democratic reforms in the late 1980s, after a rapidly growing middle class became involved in widespread civil protests. The depth of such reforms was demonstrated in the recent presidential election in Taiwan, which proved that even long-entrenched ruling parties are now subject to the will of the people.

It is extremely likely that the growth of capitalism generally and the opening of developing economies to international trade and

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investment in particular have contributed to what Samuel Huntington has called a "third wave of democratization." At the very least, economic globalization has existed alongside democratization. In 1973, of a total of 122 countries with more than 1 million people, a mere 20 nations were democratic, while 92 were nondemocratic. By 1990, however, of 129 countries, 58 were democratic, while 71 were nondemocratic. Those are startling figures: for the first time in the 20th century—during a period of unprecedented economic liberalization and globalization—the number of authoritarian or nondemocratic states actually decreased.

The relationship between economic liberalization and democratization can be further illustrated by comparing cross-country data measuring economic openness and political and civil liberties. Using the *Economic Freedom of the World* index of openness to international exchange and the Freedom House ratings of "free," "partly free," and "not free," Daniel Griswold, associate director of the Cato Institute's Center for Trade Policy Studies, has demonstrated a strong correlation between the two kinds of freedom.[16] Nations that are classified by Freedom House as being free score an average of 7.9 on the scale of economic openness. Those that are partly free averaged a less open 6.7, and those that are not free scored the lowest, 5.4. Reversing the data reveals that of the countries in the top third of the Gwartney-Lawson scale of economic openness, 84 percent earned a political-civil ranking of free. Of those in the middle third, 57 percent were free, but in the bottom third, only 22 percent were free. In other words, citizens who enjoy the freedom to engage in international commerce are about four times more likely to be free from political and civil oppression than are those who do not enjoy such freedom.

None of these data is meant to imply that there is a rigidly deterministic relationship between economic liberalization and democratic reforms. Nevertheless, it seems obvious that the growth of autonomous interest groups and sources of wealth within a country, foreign investments conditioned on solid property rights and a functioning legal system, and privatization of state-owned enterprises in response to international competition have benefited pro-democracy movements around the world.[17]

There will never be a magic formula for development or democratization. But the East Asian experience is a powerful testament to the rapid progress that can be achieved when developing countries embrace the basic tenets of globalization. The stakes are high. With the exception of countries that have embraced export-oriented development, the gap between the developed and the developing world has been either stable or growing throughout most of modern history. The export-oriented countries are succeeding because they have created outward-oriented economies that provide faster growth through exports and access to foreign technology, capital, and productivity-enhancing imports. Those who wish to improve the lives—both politically and economically—of the citizens of developing countries should be thinking of ways to facilitate globalization, not attempting to stop it.

Jobs, Wages, and Labor Standards

> Behind this [clothing] label is a shameful story of political prisoners and forced labor camps; of wages as low as thirteen cents an hour; of a country that routinely violates trade rules; flooding our markets; draining American jobs.
>
> —AFL-CIO television advertisement

It is an article of faith among "globaphobes" that the low-skilled jobs in the export industries of the developing world amount to exploitation of local workers. Globaphobes evoke images of third-world "sweatshops" and labor-intensive factories with hellish working conditions and slave wages to justify U.S. trade barriers against developing-country imports. Shutting down those factories, by any means necessary, is now a top priority of anti–free traders. In one recent high-profile example,

Table 3
Ratio of Average Wages and Salaries Paid to Non-U.S. Citizens by Affiliates of U.S. Multinationals to per Capita GDP, 1994 (by income level of host country group)

	Total	High	Middle	Low
Average wages and salaries ($1,000)	25.6	32.4	9.5	3.4
Per capita GDP ($1,000)	11.5	20.9	3.2	0.4
Ratio of wages and salaries to per capita GDP	2.2	1.6	3.0	8.5

Source: Edward M. Graham, "Trade and Investment at the WTO: Just Do It!" in *Launching New Global Trade Talks: An Action Agenda,* Special Report no. 12, Institute for International Economics, September 1998, p. 158.

students at the University of Pennsylvania, the University of Michigan, and Indiana University staged sit-in protests against the licensing of school logos to companies producing clothing in developing countries.[18] Despite the good intentions of those students, such trade-reducing actions do nothing to help improve conditions in poor countries.

It is certainly true that workers in the export sector of developing countries earn far less than their Western counterparts earn and often work in much harsher conditions. The proper comparison, however, is not between U.S. wages and developing-country wages but between export-sector wages in developing countries and other locally available opportunities. After all, it is not as though low wages and poor working conditions were a creation of multinational companies—that combination has been the rule throughout history. It is lamentable that nearly 3 billion people currently live on less than two dollars a day,[19] but the critical question to ask is, why are the other 3 billion people doing better? Globalization is an important part of that answer.

Wherever new export industries have taken hold, there has been a measurable improvement in local incomes and working conditions. In 1998 Edward M. Graham of the Institute for International Economics estimated the wages and salaries (not including fringe benefits, which generally average about 25 percent of wages and salaries) paid to local employees of U.S. affiliate companies.[20] His results—which are summarized in Table 3—suggest that, although developing-country employees of U.S. affiliates are indeed paid less than their developed-country counterparts are paid, they are paid significantly more than the average wage for the country where they live. In low-income countries, for example, workers fortunate enough to gain employment with a U.S.-based company earn more than *eight times* the average per capita salary. For middle-income countries, such workers earn about three times the average local yearly wages.

Anecdotal evidence supports Graham's statistical analysis. For example, a recent survey of 48 U.S.-based companies in China, conducted by the U.S. Chamber of Commerce in Beijing, found that respondents pay an average hourly wage of $5.25, excluding benefits, or about $10,900 per year.[21] Similarly, workers at a Shanghai factory owned jointly by General Motors and the Shanghai Automotive Industry Corporation earn about $4.59 per hour, including benefits but not counting generous performance bonuses that can almost double take-home pay.[22] While such wages are far below the average for a unionized autoworker in the United States, they are about three times higher than wages for comparable work at a non-U.S. factory in Shanghai and nearly eight times higher than the United Auto Workers' estimate: "A 'good paying' factory job with a company like General Motors pays about 59 cents an hour" in China.[23]

Other research, such as that by Jeffrey A. Frankel and David Romer of the University of California at Berkeley, has shown that trade, as

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distinct from foreign investment, also has a positive impact on developing-country wages. In a 1999 paper those authors concluded that trade exerts "a qualitatively large and robust . . . positive effect on income." After analyzing data from 150 countries, they estimated that an increase in the ratio of trade to GDP by one percentage point can be expected to raise income per person by between 0.5 and 2 percent.[24]

Both trade and investment affect the long-term production trend in developing economies, which also reinforces the gains to workers. Specifically, poor countries tend to move away from labor-intensive production as they scale the ladder of economic development. The share of textiles and apparel in South Korea's exports, for example, grew from 8 percent in 1960 to 40 percent in 1980 but then shrank to 19 percent by 1993.[25] Today South Korea is known more for its exports of automobiles and electronics than its clothing, and average wages have increased dramatically. The benefits of creating a dynamic, export-oriented manufacturing sector are even more apparent when wages are compared with those in Western countries. In 1960 the average manufacturing job in a developing country paid just over 10 percent of manufacturing wages received by workers in the United States. By 1992 wages in those countries had risen to nearly 30 percent of U.S. manufacturing wages.[26] In other words, as manufactured exports of developing countries have grown, so have wages in those countries—even in relation to U.S. wages, which also have risen.

Foreign-owned businesses not only pay their workers more, they also provide a positive example of quality of life in the workplace. In fact, in the few high-profile cases in which Western companies were tied to labor abuses, those abuses were overwhelmingly committed by indigenous firms that were selling on contract. As awareness of worker mistreatment has grown, foreign-owned firms—and, in particular, American-owned firms—have actively taken measures to ensure that workers are treated humanely. Companies have established codes of conduct for their suppliers. As the International Labor Organization reports, "Available information suggests that the world's largest multinational enterprises (MNEs), and in particular US-based MNEs in the [textiles, clothing, footwear,] and related commerce sectors (e.g., manufacturers, retailers including department stores, mass merchandisers, specialty stores and mail order clothing companies), have led the trend toward usage of codes as a means of responsible sourcing."[27] Consider the Nike Corporation, which for years has been the company that globaphobes have loved to hate. After taking voluntary steps to improve its procurement process, Nike hired former U.S. ambassador to the United Nations Andrew Young to conduct an independent investigation of the company's labor practices.[28] Focused consumer pressure, not blunt government sanctions, was responsible for Nike's internal reforms.

Zhou Latai, one of China's foremost labor attorneys who represents injured workers in the southern city of Shenzhen, puts it this way: "American consumers are a main catalyst for better worker rights in China. They are the ones who pressure Nike and Reebok to improve working conditions at Hong Kong– and Taiwan-run factories here. If Nike and Reebok go—and they could very well if [normal trade relations] is rejected—this pressure evaporates. This is obvious."[29]

Again, it is important to remember that low wages, poverty, and difficult working conditions are not new to the developing world; they have always been the norm. No doubt there will always be horror stories about unscrupulous employers, just as such stories persist in this country. Globalization is not a panacea, but curtailing trade and foreign investment will only ensure that workers are forced into the nonexport sector. For most people, that means eking a miserable living from small plots of land, or sometimes worse. More than any government program or aid package, the spread of free trade, free markets, and investment across international borders by private companies and investors is proving to be the most effective anti-poverty measure the world has ever seen.

The Seattle and Washington, D.C., protesters called for better working conditions in the

developing world while denouncing the policy that would most help bring such improvements about: free trade. Instead of closing our markets, we should be opening them further. No amount of aid money or insistence on living-wage standards could match the benefits for poor workers that tariff-free access to Western markets could offer. That access would create jobs, reduce unemployment, put upward pressure on wages, and even create a hospitable climate for labor-organizing efforts. Those are precisely the goals being sought by the anti-trade movement.

Ironically, the WTO's failure in Seattle was due not to fear of free trade on the part of developing countries but rather to the reluctance of developed countries to fully embrace it. As Sri Lankan commerce minister Kingsley Wickramaraine noted, a large number of developing countries "are yet to find any meaningful market access opportunities for products of export interest to them."[30] Unfortunately, Wickramaraine is correct: the United States and other industrialized countries continue to block imports from developing countries, especially through abnormally high tariffs on textiles and clothing, an unfair antidumping regime, and quotas on various agricultural products.[31] Such discriminatory protectionism persists despite promises made during the Uruguay Round of trade talks. In the WTO Agreement on Textiles and Clothing, for instance, the United States pledged to phase out all textile and apparel quotas over a 10-year period, but as of 1999 only 1 percent of U.S. quotas had been eliminated.[32] On average, developing countries face tariffs on their manufactured exports that are nearly four times the tariffs facing exports of developed countries.[33] Because of that inequitable pattern of protectionism, Thomas W. Hertel and Will Martin of the World Bank have concluded that developing countries would capture around 75 percent of the world economic benefits from further trade liberalization in the manufacturing sector.[34]

Trade and the Environment

> The greenies have tried to organize campaigns around the World Bank for 15 or 20 years now and have never ignited 1 percent of the people that are organized around the WTO.
>
> —Dan Seligman, director, Sierra Club's Responsible Trade Program[35]

Critics of globalization argue that multinational companies tend to invest in nations that maintain low standards of environmental protection. As international investment in developing countries becomes more widespread, competition for capital supposedly forces recipient countries into a destructive spiral by continually weakening their environmental laws and regulations. The developed countries, the critics warn, are not immune to competitive pressures and are also forced to weaken their currently high environmental standards. This supposed race to the bottom will, it is argued, lead to massive global environmental degradation.

This theory rests on the assumption that lower environmental standards give developing countries a significant advantage in attracting investment capital. Both logic and empirical experience suggest that the opposite is true. First, environmental standards are only one of many factors that businesses take into account when choosing the best location to set up shop. Such considerations as guaranteed property rights protection, a functioning legal system, a well-educated workforce, and sufficient infrastructure figure much more prominently in the calculations of most entrepreneurs and business managers than do environmental regulations. Given those facts, it is not surprising that there is scant evidence that governments actually lower environmental standards in order to attract investment.[36] Second, there are considerable cost savings associated with standardized production techniques. Thus, companies tend to operate at the *highest* environmental world standard rather than adopt multiple production technologies for use in different areas.[37] Third, much of the foreign direct investment (FDI) directed to developing countries is used to privatize inefficient state-owned manufacturers, which tend to become less polluting as they are restructured. Finally, trade and investment help speed the spread of pollution control technology

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There are serious problems of environmental degradation in developing countries, but cutting off their access to our markets is no solution.

and enable developing countries to purchase cleaner energy inputs on world markets.

The most important result of trade and investment, however, is economic growth, which in turn leads to a better environment. That is true because, as incomes rise, the demand for improved environmental quality also rises. Numerous studies have confirmed that, in practice, trade and investment activities usually have a positive impact on the environment.[38]

This is not to imply that a cleaner environment is the immediate result of economic development. Empirical studies have revealed the existence of an inverted U–shaped relationship, often called an "Environmental Kuznets Curve," after the late American economist Simon Kuznets, between environmental degradation and income per capita. The Kuznets Curve describes a process whereby environmental quality in a developing nation initially deteriorates as the economy begins to industrialize but improves after its citizens reach a certain standard of living. Research by Alan Krueger and Gene Grossman of Princeton University, for instance, indicates that the turning point occurs at about $5,000 annual income per capita: "We find no evidence that environmental quality deteriorates steadily with economic growth. Rather, for most indicators, economic growth brings an initial phase of deterioration followed by a subsequent phase of improvement." By $8,000 per capita income, the authors found that almost all the pollutant categories had begun to improve.[39]

The case for the pro-environment effects of trade and development is further supported by the experience of the Western world, and of the United States in particular. Standards for air and water quality in OECD countries are much higher now than they were even just 30 years ago—an improvement that has taken place just as FDI and the share of those economies devoted to trade have grown higher than ever.[40]

There is no evidence that increasing trade with developing countries is placing downward pressure on U.S. environmental standards. The United States is one of the world's most open economies, and its environment is one of the cleanest. Over the past decade, the United States has continued to pursue a liberal trade agenda by signing the 1994 North American Free Trade Agreement and by helping create the WTO. Meanwhile, two-way trade and foreign investment continue to climb as percentages of GDP. That growth of international trade and investment has been accompanied by ever more stringent environmental standards. According to the President's Council on Environmental Quality, mean ambient concentrations of sulfur dioxide and carbon monoxide in the atmosphere of the United States have both dropped by nearly 40 percent since 1988.[41] During that same period, 1988–97, the number of annual "bad air days" in major U.S. cities fell by two-thirds.[42] The direct discharge of toxic water pollutants is down dramatically as well.[43] Since the early 1970s, during a time of growing globalization of the U.S. economy, real spending by government and business on the environment and natural resource protection has doubled.[44]

Just as it is clear that there are serious problems of environmental degradation in developing countries, it is equally clear that cutting off their access to our markets is no solution. Depriving poor countries of trading opportunities will simply diminish their growth rates, thus delaying their departure from the ranks of countries with low GDPs, in which environmental problems are the most serious. Free trade, however, can help make industrial production less polluting even in those countries by rationalizing the use of resources both within and among developing economies. For instance, free trade often promotes the transition from heavy-resource-processing sectors to light manufacturing ones, reducing wasteful global overcapacity in higher-polluting sectors.[45] In other words, by encouraging nations to concentrate on production in their areas of greatest comparative advantage, globalization enhances total world economic efficiency and minimizes inevitable environmental costs.

Globalization Close to Home: The Case of Mexico

Although East Asia has been the most celebrated example of rapid export-driven development, the trend is also visible elsewhere, in

countries as varied as Egypt, Estonia, and Chile. Of special relevance to the United States is its southern neighbor, Mexico, which was granted relatively free access to the U.S. and Canadian markets under NAFTA. For most of the 20th century, Mexico had closed itself off from international trade and capital flows by setting up currency controls and trade barriers. Only with the Latin American debt crisis of the 1980s did Mexico slowly begin to open its economy to global trade and investment. The payoffs to Mexico's economy and workers are today undeniable.

In 1980 the percentage of Mexico's exports to the United States classified as "manufactured" was a paltry 0.7 percent. By 1990 that figure had climbed to 3.7 percent, and by 1995 it had shot up to 19.3 percent, reflecting Mexico's ongoing transformation from a stagnant oil-based economy to a more diverse manufacturing-based economy.[46] Between 1993 and 1999 Mexico climbed from 26th place to 8th place among the world's largest exporters, and in recent years Mexico's exports have fueled growth rates of 4 percent.[47] That startling transformation has been led by the growth of manufacturing maquiladoras[48] and the development of import-export business. Those new businesses are not the result of an industrial policy designed to "force" industrialization—a strategy Mexico unsuccessfully pursued for decades—but rather a natural consequence of Mexico's comparative advantages under freer trade. Clearly, the combination of reduced trade barriers and a stable legal framework for foreign investment under NAFTA helped make that shift to more manufactured exports possible.

The resulting positive changes in Mexico's economy have been astounding. "NAFTA," says Jesus Reyes-Heroles, Mexico's ambassador to the United States, "is the most important thing to happen to Mexico in the past 100 years. . . . Those who oppose it should come to Mexico." Since NAFTA's implementation, one of every four jobs generated in Mexico has been in a company that receives FDI. In total, over 20 percent of the Mexican workforce are currently employed by companies that receive FDI. "In a poor country like ours," he observes, "the alternative to low paying jobs isn't high paying jobs—it's no jobs at all."[49] Mexico's president, Ernesto Zedillo, has reached a similar conclusion: "Native people employed in the new apparel plants located in many of the Yucatan's Maya towns, migrants from the south of Mexico working at huge maquiladora industries in the northern cities of Tijuana and Juarez, young engineers with good jobs at high-tech factories in Monterrey and Guadalajara, and many others have assured me that their new occupations—unthinkable in a closed economy—are much better than their prior ones, if any."[50]

Mexico's overall stability has been enhanced by its commitments to economic openness. Opponents of free trade wrongly blame NAFTA for Mexico's disastrous peso crisis of 1994–95, which was actually caused by a combination of loose monetary policy and an inflexible and overvalued exchange rate. In fact, Mexico has suffered a severe financial crisis in every election cycle since 1976—long before anyone had ever heard of NAFTA.[51] However, Mexico's relatively rapid recovery from the most recent crisis contrasts starkly with the protracted slump that followed its 1982 debt crisis.[52] More important, whereas the slump of 1982 prompted the Mexican government to nationalize its banks and raise trade barriers, the present government successfully resisted backsliding. Just as free-trade supporters on both sides of the border had predicted, NAFTA helped to buttress Mexico's broader economic and political reforms.

The involvement of U.S. businesses has positively influenced both labor conditions and environmental quality in Mexico. First, through competition: domestic firms are increasingly forced to compete with foreign-owned businesses and joint ventures by offering better working conditions and higher pay. Second, by example: U.S. production methods and technology are demonstrating to Mexican businesses that it is possible to be both "green" *and* profitable. Far from "racing to the bottom," the Mexican government has actually *strengthened* its environmental regulations and enforcement procedures since NAFTA has been in place. Indeed, the Zedillo administration has instituted an aggressive plan to clean up Mexico's

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environment—which has suffered from decades of neglect by government and bloated state-owned businesses—by adopting a "polluter pays" strategy in concert with a system of voluntary environmental audits.[53]

The most obvious beneficiaries of trade, however, have been average Mexican workers, who were shielded from the most severe fallout of their government's unsound monetary policies. Because of the sharp devaluation of the peso, in March 1997 real manufacturing wages were still 23 percent below their precrisis level. The situation was better, however, for manufacturing jobs supported by exports. Firms with between 40 and 80 percent of their total sales going to exports during the 1994–96 period paid wages that were, at the low end, 11 percent higher than wages of non-export-oriented firms; for companies with export sales above 80 percent, wages were between 58 and 67 percent higher.[54] Workers in the oft-maligned maquiladora sector fared relatively well, experiencing only a 12 percent real wage reduction between 1994 and 1996. Overall, the maquila wage has risen from rough parity with nonexport workers in 1993 to 16 percent above nonexport workers in 1996.[55]

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The successful liberalization of trade and investment in Mexico under NAFTA has not resulted in a backlash against globalization. On the contrary, it has resulted in an even greater commitment to open Mexico's markets to other regions of the globe. A large step in that direction is the recent free-trade agreement negotiated between Mexico and the European Union, under which about 95 percent of tariffs on products traded will be completely phased out.[56] Mexico is also pursuing bilateral trade agreements with Japan, Brazil, and other countries. This strategy implies that Mexican voters are generally satisfied with the results of trade and investment liberalization in their country.

Democracy in Mexico has thrived as its economy has been opened. In fact, the current presidential elections mark the first serious threat to the long-ruling Institutional Revolutionary Party (PRI), which has held power since the 1920s. A recent opinion poll showed that Vicente Fox of the opposition National Action Party had pulled within three points of PRI's Francisco Labastida.[57] Support for Fox is particularly strong among Mexico's emerging middle class, a significant percent of whom work in sectors directly tied to international trade and foreign investment. Regardless of who ultimately prevails in the July 2 vote, the image of inevitable one-party rule in Mexico has already been shattered.

Many Mexicans will undoubtedly continue to live in conditions of grinding poverty for the foreseeable future. Nevertheless, for perhaps the first time in Mexico's history, parents can be confident that their children will have greater opportunity than they had. That is what globalization really means to our neighbors south of the border.

Saving the Poor from Development

> A [broken] storefront window becomes a vent to let some fresh air into the oppressive atmosphere of a retail outlet.
>
> —Internet communiqué from the N30 Black Bloc, an "anarchist" group active in Seattle[58]

The anti-trade agenda that coalesced on the streets of Seattle and Washington, D.C., is—intentionally or not—aimed squarely at keeping poor countries poor. Consider one of the less extreme demands of the protesters: that the WTO impose labor and environmental standards and enforce them.

Labor Standards

There is only one reason for negotiating a WTO agreement for labor standards: to impose trade sanctions on poor countries that fail to live up to it. There is already a duly constituted body, the International Labor Organization, whose mission is to raise labor standards around the world. Why then do labor activists want to bypass the ILO and start over again with the WTO? The answer is clear: the WTO, unlike the ILO, authorizes the imposition of trade sanctions against countries that violate its agreements. The campaign to include labor

standards on the WTO agenda is thus a new excuse for protectionism.

The justification offered for WTO rules in this area is that the lack of proper labor standards constitutes a form of unfair competition that distorts trade and investment flows to favor countries with abusive practices. But there is no evidence that a lack of core labor standards plays a significant role in attracting foreign investment or in enhancing export performance. In fact, the OECD has found strong evidence that the opposite, a "positive association over time between sustained trade reforms and improvements in core standards," is true.[59]

Raising trade barriers against poor countries will not improve the plight of workers in those countries. Instead, trade barriers will slow down growth in developing countries and keep people mired in poverty. In most developing countries, resource-strapped governments are simply unable to afford or enforce above-market wages and better working conditions, so no improvement will result from reducing trade. In cases in which oppression truly exists, the offending governments are unlikely to respond to the severing of international economic ties by cleaning up their acts. Indeed, isolating a country economically often has the perverse effect of weakening internal political opposition and further concentrating power in the hands of the ruling regime. As the prominent Chinese dissident Bao Tong has stated: "I appreciate the efforts of friends and colleagues to help our human rights situation, but it doesn't make sense to use trade as a lever. It just doesn't work."[60]

From the U.S. perspective, imposing trade barriers in the name of humanitarian concerns is as morally questionable as it is economically unsound. Even if the goal is the admirable one of higher wages for everyone in the long run, the means being used to achieve that goal are making some people in poor countries worse off in the short run—by destroying their livelihoods. Impoverishing average citizens has never been an effective way to change the policies of autocratic leaders, and it is even less effective in encouraging economic growth. This wrongheaded approach has been compared to the Vietnam War strategy of burning the village in order to save it.[61] That strategy has not improved with age.

The mere act of mixing labor and trade concerns inevitably hinders good-faith efforts to deal with the real problems of poverty and labor abuses. The tendency will be to focus not on where those problems are most severe but on situations in which the competitive challenges to politically powerful domestic producers are the strongest. That is why it is important to keep institutional objectives separate. As Jagdish Bhagwati of Columbia University noted: "You cannot kill two birds with one stone. . . . If you seek to do that, you will likely miss both birds."[62]

The heart-rending problem of child labor, which is often cited as a reason to bring the issue of labor standards into the WTO, is a case in point. In 1993, of an estimated 80 million children under the age of 15 who were working around the world, about 95 percent were living in developing countries.[63] According to the OECD, most child labor does not involve exports. Child labor is found most commonly in rural areas, usually on family farms, and is unpaid.[64] In urban areas, children tend to work in the informal sector, in family businesses and small shops. In general, children are compelled to work because of lack of economic opportunity, not because of malice or a lack of adequate regulation. After all, parents in developing countries want the best for their children, just as do parents in the United States. For poor families, child labor is often simply a matter of survival, not exploitation. Besides, not *all* child labor is inherently bad. Even in the developed world, work by children is widely accepted (and even applauded) as long as the burden is not unreasonable and does not interfere with schooling.

According to the ILO, the bulk of child labor takes place in the nontradable agricultural sectors of developing economies. Nearly 70 percent of working children toil as unpaid family workers.[65] Thus, attempts to root out child labor by applying trade sanctions are doomed to fail and will have a negligible impact on most child workers. Sanctions will, however, drive those children who currently work in export-related industries into the nontradable

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sector—a result that is quite surely not to the children's benefit. Moreover, child labor is most common in those places—such as most African countries—that have been the least touched by trade and globalization. Like most other problems faced by developing countries, child labor can be best addressed by development—by embracing the global economy. Conditioning access to Western markets on the elimination of child labor would be far more likely to harm than help poor children.

There is no convincing case for including labor standards in the international trading system. The result would be to undermine the low-wage comparative advantage of developing countries without raising those wages, to corrupt the trade-liberalizing mission of the WTO, and to harm the very people, including children, that such standards are supposedly intended to help.

Environmental Standards

With respect to trade rules on environmental issues, the situation is somewhat more complicated. Under limited circumstances, there may be tensions between trade policy goals and environmental goals—namely, in cases of import restrictions on products that threaten the importing country's environment or the health and safety of its citizens. WTO rules, though, already recognize the authority of national governments to restrict trade under such circumstances. But those who call for additional WTO environmental standards want to restrict such national environmental autonomy. They want the top-down imposition of one-size-fits-all regulations to be enforced by trade sanctions.

The intrusion of the WTO into environmental policymaking would be a terrible mistake. As discussed above, free trade assists the cause of rising environmental standards. Isolation from the world economy breeds only stagnation and environmental degradation—as the miserable environmental record of the Soviet-style economies attests. Imposing trade sanctions on poor countries that do not live up to international regulations would only retard those countries' development and thus slow their ability to achieve higher environmental quality. Furthermore, environmentalists in the United States insist that this country should be free to set whatever level of environmental protection it desires—a right that must also be granted to developing countries. In fact, the principle of regulatory self-determination is enshrined in the WTO itself. As Deputy U.S. Trade Representative Susan G. Esserman has pointed out, it recognizes "the right of Members to take science-based measures to achieve those levels of health, safety and environmental protection that they deem appropriate—even when such levels of protection are higher than those provided by international standards."[66] But self-determination should not be a one-way street: There are legitimate differences in culture and environmental quality preferences that should be tolerated even when they result in lower standards. Thus, the indiscriminate use of trade restrictions to discourage purely domestic practices that Western environmentalists happen to consider offensive—such as the EU's ban on fur from animals caught in leg traps—should be avoided.

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Because globalization promotes economic growth, which in turn promotes rising environmental standards, better environmental protection will occur in those countries that embrace globalization. Attempting to link enforcement of developed-country environmental norms with trade sanctions will result only in reduced trade, slower growth, and a prolonged status quo. When legitimate cross-border environmental issues need to be addressed, the WTO is not the proper forum in which to address them.

A New Colonialism?

Anti-trade activists often voice concern for the political rights of the citizens of developing countries. Never mind that most members of the WTO are already functioning democracies—the presumption seems to be that a democratic electorate will naturally demand Western-style labor and environmental regulations, so when such regulations are not present, democracy must be a charade. The notion that there are silent, politically disenfranchised masses evidently makes championing their

cause—often over the objections of duly elected representatives—more palatable to relatively affluent Western protesters.

Democratic reform, where it is needed, is a worthy goal. The most realistic path to achieving reform is through economic liberalization. Economic freedom and political freedom are intimately intertwined: the former cannot be established without creating intense pressures for the latter. And trade is first and foremost a matter of freedom. When a government tells its citizens that they may not buy from or sell to foreigners, it has significantly curtailed their liberty. Moreover, it is arrogant to argue that citizens of developing countries need to be protected from commercial dealings with other countries—that they will always be swindled, exploited, or outfoxed by savvy foreigners.

The anti-globalization demonstrations seem to have strengthened the resolve of developing countries to resist attempts by their self-appointed defenders to force a labor or an environmental agenda on the WTO. As one Gabonese diplomat who was blocked from attending the Seattle meetings noted with disgust, "[The protesters] understand nothing, and are as remote from our problems as you'd expect from middle-class whites in Washington state."[67] Or as Mexico's president, Ernesto Zedillo, recently observed:

> A peculiar alliance has recently come into life. Forces from the extreme left, the extreme right, environmentalist groups, trade unions of developed countries and some self-appointed representatives of civil society, are gathering around a common endeavor: to save the people of developing countries from—development.[68]

The spectacle of rich Americans marching unbidden in the name of downtrodden foreigners reached absurd heights during the April protests in Washington, D.C. Lacking a significant presence of protectionist-minded union members, the demonstrations were populated almost exclusively by students, many of whom wore costumes and used various forms of street theater to make their points. As a D.C. police officer sagely remarked to a group of teenage protesters as they faced each other over the barricades, "I understand that you all claim to want to help the poor oppressed people of the world, but what I don't understand is why none—and I mean *none*—of those people are here."[69]

A Pro-Trade, Pro-Freedom Agenda

There are many problems facing developing countries, but an excess of international trade and investment is not among those problems. Contrary to popular perception, U.S. businesses are not rapidly relocating production facilities to developing countries. For developing countries foreign investment is a blessing that is in woefully short supply. From 1985 to 1995, net outflows of FDI from industrial to developing countries were only about 2 percent of total capital formation in developed countries.[70] Indeed, a recent UN Conference on Trade and Development report described the "increasing marginalization" of the world's 48 poorest countries, which are in danger of falling further behind more developed competitors in an increasingly globalized economy. According to that report, the world's least-developed countries accounted for 13 percent of the world's population in 1997 but represented only a 0.4 percent share of the world's exports and a 0.6 percent share of imports.[71]

Despite the positive impact that international trade and investment have had in developing countries, poverty, worker mistreatment, and human rights abuses remain in some places. The natural response of Americans is to call for action that will improve those miserable conditions abroad. Useful policy tools do in fact exist, and new ones are continually being proposed. Two rules, however, should guide U.S. policymakers when evaluating any policy designed to improve conditions in developing countries. First, it must be remembered that, despite often-noble intentions, the U.S. government is limited in its capacity to effect change abroad. Poor countries cannot be compelled to develop through threats or sanctions—they must make

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that journey voluntarily. The age of imperialism is over, and attempts to revive it in other guises are doomed to failure. Second, the following question must be asked of any proposed measure: Will it place limits on the freedom to engage in voluntary cross-border exchange? If the answer to that question is yes, the policy will imperil wealth creation and should be rejected.

Above all, the United States must remain a committed member of the WTO and a champion of a liberal world trading system. That means not only rejecting the current legislation in Congress that would end U.S. membership in the WTO but also keeping existing commitments to reduce trade barriers—an area in which Washington has often dragged its feet. In addition, U.S. negotiators should work to launch a new round of multilateral trade negotiations that would address such areas as services, agriculture, and electronic commerce. The WTO's dispute settlement mechanism, although on the whole a tremendous success, is also in need of reform with respect to the enforcement of WTO rulings. Specifically, countries that refuse to implement adverse rulings should be required to offer offsetting liberalization rather than be subject to trade-restricting sanctions.[72]

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The United States should also take aggressive steps to unilaterally reduce its remaining trade barriers and end practices that unfairly discriminate against foreign producers and thereby encourage other nations to do the same. In particular, poor-country exports—for example, textiles and clothing—often face such barriers as absurdly high (12 to 30 percent) tariffs that should be scrapped. Tariffs on environmental goods and services—factory smokestack scrubbers and the like—should also be eliminated immediately, since trade in such products encourages environmental stewardship worldwide. Another important step Washington should take, however, would be to repeal or reform the unfair U.S. antidumping law, the aggressive use of which has seriously compromised our ability to encourage freer markets abroad.[73]

Of course, there are appropriate occasions to take actions against *specific* instances of human rights abuses abroad, such as cases of involuntary prison labor. Keeping in mind a core commitment to free trade, the following is a brief list of useful trade-friendly options that policymakers might consider if they believe they should address some particular abusive practice.

First, the United States should continue to work within the framework of the ILO when dealing with governments and corporations that engage in abusive practices. That can be accomplished by spotlighting such practices in official reports and investigations. The ILO is a better forum than the WTO for resolving disputes over labor standards, both because the ILO has more experience with those issues and because it is far less likely to provide cover for covert protectionism.

Second, direct foreign aid payments can be suspended when foreign governments engage in abusive practices. Suspending direct aid is a viable way to signal strong disapproval of the actions of foreign governments without violating the rights of Americans or disrupting beneficial private commercial exchange. In addition, U.S. directors at international financial institutions, such as the International Monetary Fund and the World Bank, can be instructed, when circumstances warrant, to vote against loans to objectionable governments.

Third, by blocking credits and loan guarantees from the Export-Import Bank and the Overseas Private Investment Corp., Congress can ban corporate welfare for companies that mistreat their workers or that do business with abusive governments. That will adversely affect some U.S. businesses, but subsidizing private investment abroad has never been a good idea. The provision of loan guarantees and subsidized insurance to the private sector has reduced pressure on foreign governments to create an investment environment that would attract foreign capital on its own. To attract investment, developing countries must establish secure property rights, a fair and uncorrupted judiciary, and transparent democratic accountability rather than rely on Washington-backed schemes that allow those reforms to be avoided.

Fourth, private initiatives can play an important role in ending abusive practices and alleviating the burdens of poverty abroad. As the AFL-CIO has noted, "Polls show that people are willing to pay more if they can be assured

that their clothes were not made in sweatshops."[74] If that is the case, then corporations and investors will respond to consumer demand and public pressure, as many already have. Companies can label their products to show that they were made in compliance with appropriate labor and environmental standards. Outside auditors can ensure the integrity of such labeling. And consumers can vote with their wallets in favor of such products if they so choose. In addition, there are many worthwhile charitable activities to which people can contribute their money and time—such as building schools and hiring teachers for poor villages so that children have an alternative to working in the fields.

Finally, various "symbolic" sanctions—such as restrictions on U.S. visas for officials of abusive governments, or bans on countries' participation in international sporting events—can serve a useful purpose. Such narrowly targeted sanctions can be a powerful force for change, without inflicting the senseless collateral damage of economic sanctions. In 1993 the *Financial Times* noted that sporting sanctions against South Africa "were the most effective of all [sanctions]—not least because these measures had a clear and unambiguous impact, unlike economic sanctions whose effects are difficult to differentiate from normal market forces."[75]

It bears repeating that any blanket remedy that disrupts trade and investment is counterproductive and should be rejected. Import bans hurt poor people by making them more miserable in the short run in order to put pressure on leaders to make positive changes in the long run. Unfortunately, such pressure is rarely effective in a world where U.S. companies no longer dominate global trade. The decades-old embargo against Cuba, for example, has harmed the Cuban people and caused lost opportunities for U.S. businesses; yet the embargo has done nothing to bring about democratization in that country. Given that sanctions have a poor record of achieving foreign policy goals, we should not expect sanctions to be any more successful in achieving social objectives.

The humanitarian impulse is a commendable aspect of American culture. But humanitarians must be clear-eyed about the real options for the impoverished billions that still make up the majority of humankind. Poverty and want cannot be legislated away and cannot be cured by bureaucratic aid distribution; the evils of abject poverty and deprivation can be conquered only by the creation of wealth. Denying access to U.S. markets and investment capital makes it unnecessarily difficult for the world's poorest people to build better lives.

Denying access to U.S. markets and investment capital makes it unnecessarily difficult for the world's poorest people to build better lives.

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69. The author heard this exchange during the Washington, D.C., protests against the IMF, the World Bank, and the WTO (and other evils) on April 16, 2000.

70. Stephen S. Golub, *Labour Costs and International Trade* (Washington: American Enterprise Institute, 1999), p. 15.

71. "World's Poorest Nations Left Trailing by Globalization," Financial Times Asia Intelligence Wire, February 14, 2000. See also UN Conference on Trade and Development, *The Least Developed Countries 1998 Report Overview,* http://www.unctad.org/en/docs/ldc98ove.pdf.

72. See Lindsey et al.

73. See Brink Lindsey, "The U.S. Antidumping Law: Rhetoric versus Reality," Cato Institute Trade Policy Analysis no. 7, August 16, 1999.

74. Mazur, p. 91.

75. Philip Gawith and Patti Waldmeir, "Market Forces Were the Power behind Sanctions," *Financial Times,* September 25, 1993.

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