



FAO CORPORATE DOCUMENT REPOSITORY

Produced by: [Technical Cooperation](#)
[Department](#)

Title: MULTILATERAL TRADE NEGOTIATIONS ON AGRICULTURE - A
RESOURCE MANUAL / ...

[Español](#) [Français](#)

[More details](#)



I. Introduction and General Topics

Module 2

International Trade: Some Basic Theories and Concepts

José María Caballero, Maria Grazia Quieti and Materne Maetz
Policy Assistance Division

PURPOSE

This module provides an introduction to some of the theoretical concepts and arguments used in the discussion of trade policy. The concepts and arguments presented in the module refer to trade in general, but they are illustrated as much as possible with examples from the agricultural sector and their usefulness to examine agricultural trade is highlighted.

CONTENTS

- 2.1 The economic gains from trade
- 2.2 Trade and equity
- 2.3 Protection vs. free trade: arguments and debate
- 2.4 Regional trading blocs
- 2.5 Recent public opinion concerns on international trade

KEY POINTS

- Trade can bring benefits by allowing countries to exploit their comparative advantage, reap the benefits of scale economies and ensure competition, greater variety and, potentially, more stable markets and prices.
- The gains from trade are not likely to be evenly distributed, either within or between countries, thus explaining opposition to free trade policies by some parties.
- The political decision is rarely either to trade or not to trade, but whether to impose barriers to trade. Arguments for protection can be made on either economic or non-economic grounds, including food security. However, trade measures are usually neither the most direct nor the most efficient measures to use to achieve these objectives.
- Trade liberalization can take place either within a multilateral or regional framework. Regional trade arrangements are increasingly prevalent, although the role of agriculture in these arrangements is often problematic.
- The trade policy agenda increasingly reflects new concerns raised by consumer and NGO groups in the OECD countries rather than the traditional concerns of declining terms of trade and unequal exchange raised by developing countries.

2.1 THE ECONOMIC GAINS FROM TRADE

Why countries engage in trade

Is trade advantageous? What are the reasons that move private individuals and firms to voluntarily engage in trade, governments to favour it and economists to defend it? As shown in Module I.1 *Trends in World and Agricultural Trade*, long-term international trade flows in a wide range of commodities have steadily increased over hundreds of years and they have accelerated spectacularly since the Second World War. This is surely not just because transport and communications facilities have dramatically improved, but it must also be because benefits are derived from trade.

Economists have put forward a number of arguments in favour of trade; some are rather obvious and common sense, others are less evident. These arguments can be classified into three groups according to whether they emphasize (i) the increase that trade can bring to the total amount of goods and services available to the national population (increased consumption argument), (ii) the diversity of goods and services made available through trade to this population (diversification argument), or (iii) the stability in the supply and prices of goods and services brought about by trade (stability argument). We examine these arguments below.

2.1.1 Trade and growth - the increased consumption argument

Comparative cost theory

One reason why the amount of goods and services available to a country at a point in time can increase through trade is because it allows the country to buy goods and services from sources where it costs comparatively less to produce them. Local resources tied up in the production of these goods in the absence of trade are hence liberated so that comparatively more of other goods can be produced. If the United States can produce both computer chips and sugar but is much better at producing computer chips, while Brazil can also produce computer chips and sugar but is much better at producing sugar, then both countries can benefit from trade in these items. The total amount of resources used to produce the combined quantities of sugar and computer chips consumed by the United States and Brazil will be less for each country if Brazil specialized in the production of sugar and the United States in that of computer chips, with Brazilian sugar being traded for United States chips.

The gains from trade

This joint **gain from trade** is shared between United States and Brazil. The way it is shared depends on the international price relation between computer chips and sugar, i.e. the rate at which they are traded - what economists call the external **terms of trade**. In the absence of trade, each country has its own domestic exchange ratio of sugar to chips, say one standard chip exchanges for 50 kg of sugar in the United States and for 100 kg in Brazil. Note that these exchange rates express the greater relative efficiency of producing sugar in Brazil and chips in the United States. The terms of trade will be contained between the exchange ratios of the United States and Brazil, since otherwise one of the countries would not be interested in trading. Trading will favour a country more, the farther away the international terms of trade are from its own exchange ratio¹.

Comparative advantage theory and some corollaries

The above is the classical comparative cost theory of the gains from trade, also known as comparative advantage theory, originally stated by David Ricardo in the early part of the 19th century. It is useful to present it in some detail because it is the single most powerful explanation of the gains from trade put forward by the economic profession. Several things should be noticed in this explanation, which are highlighted below, while some qualifications to the theory are given in Box 2.

Trade gains arise because of

*differences
in
opportunity
costs*

- First, gains arise from the existence of different domestic exchange ratios of the two goods in the two countries. These exchange ratios are associated with different production conditions of the two goods in the two countries. Thus, in our example, compared with the resources required to produce one chip, more resources are needed to produce one kg of sugar in the United States than in Brazil, twice as many under the simplifying assumptions used. In general, if resources are scarce and can be used to produce two goods, say A and B, the output of B foregone because of committing resources to producing one unit of A is what economists call the opportunity cost of A (in terms of B). In the above example, the opportunity cost of chips (in terms of sugar) is bigger in the United States than in Brazil, since, under the simplifying assumptions, to produce one chip we have to give up producing 100 kg of sugar in Brazil but only 50 in the United States. The gains from trade arise because the opportunity costs of sugar and chips are different in the United States and Brazil.

*Comparative
advantage is
the key to
trade, not
absolute
advantage*

- Second, the amount of resources needed to produce both commodities may be higher in one of the countries, and trade can still be advantageous to both parties. Thus, for instance, in our example we can assume the United States to use less resources in the production of chips than Brazil (which is probably the case in practice) and **also** to use less resources in the production of sugar (which is not so evident in practice but might be the case). Thus, Brazil may need to use four times more resources to produce chips and twice the resources to produce sugar than the United States, thus being absolutely less efficient in both. This is numerically illustrated in Box 1.

The important point of the theory of comparative costs is that, even in this case, the United States will still benefit from trading chips for sugar with Brazil. The reason is that by exporting one chip to Brazil, the United States can obtain 100 kg of sugar, whereas to obtain 100 kg of sugar in the United States would have cost two chips. Traders would make a good profit buying chips in the United States, sending them to Brazil, selling the chips there, buying sugar with the proceeds, bringing the sugar back to the United States, and selling it to buy more chips. In our example, at the end of this operation the trader would end up with double the amount of chips (ignoring transport and marketing costs). Of course, after a while, if many traders entered the game, the continuous selling of chips and buying of sugar in Brazil would push up the price of sugar and push down that of chips, modifying the domestic price ratio. The opposite

would be the case in the United States. This would go on until a common international price ratio is reached capable of simultaneously bringing market equilibrium in the two countries. The domestic price ratios will then diverge only on account of transport and marketing costs.

Box 1: Production resources required (Number of labour units needed to produce one kg of sugar and one standard computer chip¹)

	<u>Brazil</u>	<u>United States</u>
Computer Chips	600	150
Sugar	6	3
Exchange ratios (kg/chip)	100:1	50:1
¹ It is assumed that only one resource, labour, enters into the production of both sugar and chips. Alternatively, it could be assumed that various resources are required but that they can be represented and measured by means of a "composite resource".		

Because of comparatively (i.e. relatively) lower costs in the production of sugar, Brazil is said to have a **comparative advantage** over the United States in sugar production. The concept of comparative advantage has to be distinguished from that of **absolute advantage**, which indicates that the country in question uses in absolute terms fewer resources in the production of the given commodity. Thus, in our example, the United States has an absolute advantage in the production of both chips and sugar and a comparative advantage in the production of chips only. The basic tenet of the comparative cost theory is that the gains from trade arise from the existence of a comparative cost advantage and not of an absolute cost advantage.

Comparative advantage may need to be created

- Third, the theory is static. It explains trade and trade gains on the basis of comparative advantage at a certain point in time. It may be the case that comparative advantages change and can be acquired over time through, *inter alia*, policy action. In that case, having a comparative advantage in one good would not necessarily imply that a country should specialize in the production of that good at the expense of other lines of production. In fact, new industries (so-called *infant industries*) may not have a comparative advantage when they are being established and, as we will see below, may need to be protected

until they achieve the size required to benefit from economies of scale. Thus, in our example, Brazil would not necessarily commit itself to the production of sugar, totally forgetting about computer chips, if it felt it had the basis for developing a viable chip industry in the longer term. This kind of reasoning in fact led Brazil to put trade barriers to the import of computer equipment with the intention to develop over time some advantage in the domestic production of computers. Note, of course, that trade policy may not be the most effective way of developing an indigenous industrial capacity if more direct industrial policies are available. Countries may also lose comparative advantage in certain types of production as technology evolves abroad (the so-called *sunset industries* issue). In addition, world prices change over time, impacting on a country's comparative advantage.

Box 2: Some qualifications on the theory of comparative costs

- The theory assumes that resources are fully utilized, i.e. there is full employment, since otherwise the domestic price ratios would not reflect opportunity costs. Thus, if there are idle resources, there is no need to decrease the production of sugar to increase that of chips or *vice versa*.
- It assumes that resources can easily be reallocated to those activities in which a country has comparative advantage. In the real world, there are a number of constraints which may make it difficult to reallocate resources. Thus there are potentially high adjustment costs in moving from one line of production to another, e.g. from sugar production to chocolate production. The capital used in sugar factories cannot be used for chocolate production and workers have to be trained to use a different technology.
- In the classical model, investment resources are not internationally mobile (only commodities can move) and investment decisions are taken on a national basis. In today's world, capital is highly

mobile across national boundaries, and so is technology. Furthermore, the decision-making framework for a growing part of world investment is international and not national. A large investment fund or a transnational corporation are not restricted by national boundaries; they search for profit opportunities anywhere in the world - a concept closer to that of absolute than to comparative advantage. Factors determining investment location, and therefore trade flows, are lower labour costs, availability of natural resources and distance to raw material and major markets, as well as opportunities for establishing an efficient marketing and distribution set-up.

- The theory of comparative advantage is mostly concerned with the efficient use of resources for producing a limited number of very homogenous commodities. Today, the quality and the volume that can be delivered by a particular supplier is often more important than the cost. In a sense, the capacity to sell is becoming more important than the capacity to produce.

Trade has important distributional effects

- Fourth, the theory shows that countries as a whole gain from trade but makes no reference to whether and how different groups within each country benefit or lose from trade. As we will see below, trade can have important impacts on income distribution and this adds a social dimension to the trade issue. It is precisely because of trade's potentially negative impact on the incomes of certain groups that the United States has traditionally protected its sugar industry, restricting the imports of this product through a quota system.

Economies of scale

*Trade
allows scale
economies
to be
achieved*

Another reason why trade can increase efficiency is because it allows an expansion of the market for a certain industry beyond the limits of the domestic economy. Through exports, the output of the industry can expand and, if there are economies of scale, the average cost of the industry's products will fall.

There are two ways in which economies of scale may occur at the industry level, which will normally operate in conjunction. One is through technological indivisibilities in the firms that make up the industry, for instance, the use of robots in car manufacturing. This happens when there are cost saving technologies that can only be introduced after a certain level of output is reached. In this case, economists talk of economies of scale **internal to the firms** in the industry. The other is through the existence of cost savings that take place through the sheer expansion of the industry, mostly because of an improvement in the services supplied to the industry by third parties or the technical or commercial environment in which it operates - what economists call **external effects**. In this case the economies of scale are **external to the firm but internal to the industry**. Examples of these are the development of a skilled labour force, specialized suppliers of inputs, a competitive atmosphere and a shared technological know-how, all of which will reduce costs.

An interesting thing about economies of scale is that, if they are significant, countries with few differences in resources or in technology, and hence in production costs, will gain from specializing in different products and trading them. With specialization, the two countries can reap the economies of scale in the commodity in which they specialize, lowering the cost of production. Economies of scale, combined with product differentiation (see below) explain the phenomenon of **intra-industry trade** in which countries trade similar, but differentiated, products with each other, e.g. simultaneously importing and exporting different makes of cars.

Competition through trade

*Trade
ensures the
benefits of
competition*

One more way in which international trade can raise efficiency is through the enhancement of competition. By opening their frontiers to trade, countries force their industries to compete with goods and services produced abroad, and hence to struggle to become competitive and pass on cost reductions to consumers in the form of lower prices. In industries which tend to be monopolistic or oligopolistic because of the nature of the production process (e.g. presence of big entry costs, large economies of scale, dependence on a specialized input in short supply), this may be particularly important.

The car and telecommunication industries are examples of this. Trade may be a good way to bring competition and raise efficiency in these industries. This advantage of trade is not very relevant in agriculture since, because there are many farms producing very similar commodities, the farm sector is hardly a concentrated industry. However, farmers may benefit from the increased efficiency of input supply industries or food processing industries brought about through trade.

2.1.2 Trade and access to goods - the diversification argument

Trade increases the variety of goods

A different reason why trade is beneficial is because it makes accessible to national consumers and producers an array of goods and services that would not be available otherwise. Since these include consumer goods as well as capital goods and inputs, trade favours both domestic consumers and the development of the domestic production capacity.

Diversity refers to the availability of goods that cannot be produced in the country or could only be produced under very special and expensive conditions (e.g. mangoes in Scandinavia). It also refers to different types or brands of goods actually produced in the country (e.g. different types of apples, motor pumps or meat cuts) or goods which are not produced in the country but could eventually be produced there with acceptable costs. Through **product differentiation** countries do not need to either fully specialize in industries where they have a comparative advantage or totally abandon industries where they do not; they can specialize in industrial niches (e.g. different makes of cars) and carry out mutually beneficial trade in niche products of industries where trading partners also operate. Intra-industry trade of this kind is common in consumer goods industries, but is less characteristic of trade in agricultural products because of the importance of natural resource endowments and their greater homogeneity.

2.1.3 Trade and fluctuations - the stability argument

Trade can stabilize markets compared to autarky...

Trade may also serve to smooth out transitory excess demand or excess supply situations in domestic markets, thus avoiding or reducing price fluctuations and eventual supply shortages. Agricultural products may benefit especially in this respect from foreign trade, since agricultural markets tend to be particularly unstable as a consequence of supply rigidities (it takes time for agricultural production to respond to market signals), exogenous factors affecting production (such as weather and pest conditions) and the fact that the

demand for food tends to vary little when prices go up or down (it is *inelastic*). A country largely self-sufficient in food and agricultural products may have agricultural surpluses in good years, which will place strong downward pressure on farm prices. The international market may serve to dispose of these surpluses with minimum disruption of domestic prices and incomes. The opposite will happen in poor agricultural years.

*...but may
itself be a
source of
instability*

It should be noticed, however, that trade may itself be a source of price instability. Thus, if a country is highly specialized in the production of some export commodities and depends largely on imports of other commodities, it will be very exposed to international price fluctuations. These fluctuations are also felt in tradable goods which are only marginally exported or imported, in the absence of policy instruments designed to isolate domestic prices from world price fluctuations. Agriculture has traditionally been the main sector where these instruments have been applied, with varying effects. This is not surprising in view of the characteristic instability of international agricultural prices and the importance attached by governments to the stabilization of food prices and farmers' incomes.

2.2 TRADE AND EQUITY

Will the benefits from trade be fairly distributed? Will everybody win or at least not lose? Two issues can be distinguished here; one is the impact of trade on different economic or social groups within a country, the other is whether the gains from trade are fairly distributed between trading countries. These issues are examined separately below.

2.2.1 The impact of trade on income distribution within a country

*There are
winners and
losers from
trade*

It is obvious that workers, entrepreneurs, investors and owners of natural resources (i.e. the owners of productive factors) engaged in export industries stand to win from increased trade since their activities develop if exports expand. Contrariwise, the owners of factors engaged in industries which have to compete with products imported from abroad, i.e. of **import-competing industries**, stand to lose from increased trade. The distribution of the gains and losses arising from trade among the owners of productive factors will depend on the situation in the respective markets. In general, however, factors which are intensively used in an industry, for instance labour in textile industries or land in extensive farming, will stand to gain or lose more than those not intensively used. Similarly, owners of factors that are rather specific to the industry and hence relatively immobile, for instance workers skilled in some agricultural operations (e.g. pruning)

or the owners of lands particularly suited to the production of specific crops, will gain or lose more than the owners of more undifferentiated and mobile factors.

If no domestic industries produce the imported good (or close substitutes), consumers (or the producers that use it as an input) will benefit from trade, without anyone losing. Intra-industry trade, where differentiated products from the same industry are traded, will in general have less negative impact on the domestic import-competing industry than trade based on specialization, where the import-competing industry may risk being totally swept away.

*Farmers are
vulnerable
to trade
changes
because of
the lack of
alternative
opportunities*

Since, in comparison with other industries, factor mobility and product differentiation are rather limited in agriculture, the farming sector is particularly vulnerable to the impact of trade. Thus, it is difficult for agricultural land to change its use to urban or recreational use in response to import competition, or for agricultural labour to find another type of employment since this normally requires reskilling and will often imply migration. It is possible for farmers to change crops to adjust to international competition, but weather, soils, technical know-how and other factors that may restrict or jeopardize possible changes will often come into play. Shifting from plantation or livestock farming to other type of agriculture will be particularly expensive and take a long time. These rigidities, typical of the farm sector, are one of the reasons why governments have traditionally tended to protect farmers from the effects of international competition.

An issue that has received much attention from trade welfare theorists is whether those who benefit from the opening of trade can compensate those who lose, so that the opposition of the latter to a free trade regime can be overcome and the gains from trade are better distributed. This may be possible in principle, but it is extremely complex in practice. The reason is the difficulty of agreeing on the exact amount of gains and losses and the identification of the groups involved, as well as that of establishing a mechanism to carry out direct payments from one group to the other. Governments may try to collect part of the gains, for instance, through export taxation. They may also be called to assist the losers, through some type of subsidy or transfer, but they will normally do this using taxpayers' (rather than exporters') money.

2.2.2 How do different countries benefit from trade?

This is a highly contentious subject surrounded by controversy and contrasting points of view. We cannot survey them all here but we will summarize some of the most representative ones.

The "mainstream economics" view

Mainstream theories emphasize the role of demand in explaining the distribution of trade gains between countries

The first view we have called "mainstream economics" to emphasize a theoretical tradition that is at the core of conventional Western academic economic thinking on international trade issues. While "mainstream economics" has much to say on the benefits deriving from trade and the welfare implications of protectionist policies and regional trade agreements, it does not offer much by way of predictions with respect to the intercountry distribution of trade gains.

As mentioned before, under the comparative cost theory the distribution of benefits is inversely related to the closeness of the international terms of trade to the domestic price ratio. However, in the original formulation of the theory by David Ricardo there was no explanation of how close the terms of trade would be to either of the domestic price ratios. Later economists, such as John Stuart Mill, stressed the role of demand factors in the determination of the terms of trade. Thus, if in our example, United States consumers are much more eager demanders of sugar than of chips compared to their Brazilian counterparts, the terms of trade will favour Brazil², which will obtain most of the gains. This was a step forward but not yet a fully satisfactory theory since there was no explanation of the determinants of the demand for imported/exported commodities.

In more modern forms of the theory, the terms of trade continue to depend on the relative strength of the respective demands. The main prediction arising from this reformulation is a dynamic one stating that **export-biased growth**, i.e. growth based on technological advance in the export industry of a country, would turn the terms of trade against the country, lowering its share in the gains³. The opposite would happen with **import-biased growth**. The reason is straightforward: export-biased growth permits a decrease in the cost of exported goods relative to imported goods and hence results in a fall in the terms of trade. The opposite is the case with import-biased growth. In our example, if there is a technological breakthrough in the semiconductor industry, and hence in the production of chips, but not in that of sugar, there will be a tendency, under competitive conditions, for the price of chips to decrease *vis-à-vis* that of sugar. The above effects only take place, however, if the participation in world trade of the country in question is sufficiently large for a reduction in the domestic production cost to influence the international price of the commodity.

**Structuralists
argue that
the
periphery is
disadvantaged
relative to
core
countries**

In the 1950s and 1960s, the distribution of trade gains between developed countries (the "centre" of the world economy) and less developed countries (the "periphery") became an issue of intense debate, due in no small part to the intellectual influence of Raul Prebisch, the Argentinean economist who was for many years at the head of the UN Economic Commission for Latin America and one of the fathers of the Latin American structuralist school. The argument is based on the assumption of trade specialization between centre and periphery, with the centre specializing in exporting manufactured industrial products and the periphery primary commodities. After observing (and measuring) a secular decline in the terms of trade of primary commodities *vis-à-vis* manufactured goods, the structuralists set about to explain the reasons for this.

The decline was viewed not as a transitory phenomenon due to a specific set of circumstances but as something embedded in the structural features of central and peripheral economies and in the nature of the development process. In a nutshell, the declining trend in the terms of trade for countries in the periphery⁴ was explained by three reasons.

1. The income elasticity of the demand for imports is lower at the centre than in the periphery due to the different type of the goods imported by both sets of countries - primary commodities in one case, industrial products in the other⁵. The consequence is that the process of growth, and hence of income expansion, raises import demand more in the periphery than at the centre pushing up the prices of periphery imports *vis-à-vis* those of exports and thus lowering the terms of trade.
2. Asymmetries are postulated in the impact of technological change at the centre and in the periphery. In central countries, it is argued that technological progress tends to decrease the demand for periphery country exports (many of which are substituted by synthetic products). On the contrary, technological progress in the periphery increases the demand for capital goods and inputs produced at the centre. This also lowers the terms of trade.
3. Product and factor markets are argued to be less competitive at the centre than in the periphery, with prices (particularly wage rates) showing more downward rigidity in the centre. As a consequence, cost savings from technical progress are passed on to export prices more in the periphery than in the

centre, where a significant portion of these savings goes to improve wages. Also, during the downturn of the business cycle the prices of export products fall proportionally more in the periphery than at the centre.

A natural policy corollary of the structuralist view was the emphasis on industrialization as a vehicle for development, for if the diagnosis of the long-term evolution of the terms of trade was right, the development process could not rely on export-led growth based on primary products. The development policy associated with this view in the Latin American context of the time has come to be known as **import-substitution strategy**. This strategy is summarized in Box 3.

Unequal exchange and dependency views

Unequal exchange is a normative concept

Theorists subscribing to the so-called "unequal exchange" view have also insisted on the uneven distribution of trade gains between the centre and the periphery. A key difference with the structuralists is that, while the latter focus on the trend over time of an observable variable, the terms of trade, the former have a more normative approach, focussing on the "unfairness" of trade between the two sets of countries at any given point in time.

Unequal exchange refers to the terms on which different commodities entering trade between the centre and the periphery are exchanged. Exchange is said to be unequal (in the normative sense of "unfair") because production conditions in the periphery lead to exporting goods at cheaper prices than if the conditions had been those of the centre. At any point in time, production conditions at the centre lead to high prices of the commodities exported, whereas production conditions in the periphery lead to cheap prices of exports.

What are the differences in production conditions between centre and periphery that give rise to unequal exchange? There are many answers to this question but we will consider two.

Box 3: The import-substitution strategy and its denouement

The thrust of the strategy was a change of development engine from the promotion of exports to the substitution of imports and from investment in primary products (agricultural raw materials, minerals and fuels) to investments in the development of the manufacturing sector. Industrialization required a number of conditions:

- (i) protecting infant industries from international competition;

- (ii) financial and fiscal support to these industries;
- (iii) the development of domestic infrastructure in the transport, communication and energy sectors;
- (iv) the enlargement of the domestic market so that it could absorb the manufacturing goods produced internally, to be achieved through suitable income distribution measures such as agrarian reform, social welfare and improved wages;
- (v) the contribution of direct and indirect foreign investment, and
- (vi) a strong and rational (i.e. planning-oriented) government of a new type, representing the aspirations of the emerging industry-related classes, as opposed to those of the traditional land-owning and intermediary bourgeoisie groups.

This policy package was very successful in creating an industrial base and pushing up growth rates throughout most of the Latin-American region in the post-war decades, until the late 1970s and early 1980s. This happened, however, in a macroeconomic climate of recurrent economic cycles, fiscal and monetary permissiveness, mounting inflation and overvalued exchange rates, which led to recurrent fiscal and balance of payment disequilibria. It is generally acknowledged today that, in the end, these disequilibria led to the exhaustion of the model's development potential, at least under its traditional form. This happened roughly in two phases.

First, in the 1970s, the macroeconomic disequilibria, which had been generally moderate up to then were exacerbated by the abandonment of convertibility by the United States and the consequent proliferation of flexible exchange regimes. This generated a relaxation of discipline in the international monetary system, exacerbated by the oil shocks, which led to international inflation. They were cushioned, however, by the undisturbed accumulation of a growing international debt in most countries in the region, facilitated by the enormous excess liquidity existing at the time in international capital markets, much of which found its way into Latin America in the form of international loans.

Second, in the 1980s, the disequilibria became unsustainable due to a combination of three factors: (i) the drying up of fresh capital inflows

due to growing repayment difficulties; (ii) a big international increase in interest rates; and (iii) a long-lasting international recession, which resulted in a big fall in the prices of Latin American primary export products. These factors precipitated the so-called debt crisis (i.e. the inability to service the debt) which marked the end of the import substitution strategy and the opening of the structural adjustment era.

Trade is seen as unfair where different values are placed on equivalent labour...

The first is that of Arghiri Emmanuel - the "classical" theorist of unequal exchange. Emmanuel's answer is *wage rates*. He assumes that institutional factors and negotiation (through union activity) set wage rates at the centre, and that wage rates determine prices and not the other way around. Capital is assumed to be mobile, and hence there is a tendency for the same rate of profit to be obtained at the centre and in the periphery. Because of historical circumstances, he argues, wage rates at the centre are much higher than in the periphery, the difference being greater than the difference in labour productivity. Higher wage rates together with an equal rate of profit give rise to higher prices at the centre, generating unequal exchange. Thus, if the centre had to supply for itself the commodities imported from the periphery it would produce them at much higher wages and hence would have to pay much more. This is true even after adjusting for productivity differences since differences in wages are bigger than those in productivity. Notice that Emmanuel, just like the structuralists, does not argue that the periphery will not benefit from trade but that the distribution of gains will be favourable to the centre.

From a policy perspective, no obvious recommendations emerge from the unequal exchange theory since there is little that policy can do to bridge the wage gap between centre and periphery countries. It is interesting, however, that the wage gap argument has been intensively used by labour unions in central countries to advocate protection, particularly in the United States. But the argument is used in this case in the context of unequal competition rather than that of unequal exchange. Thus, workers in central countries, e.g. United States textile or sugar workers, complain against the "unfair" competition from textiles imported from South Asia or sugar imported from South America, which are produced by workers earning wages several times lower than theirs.

...or because it appears to perpetuate

under-

development A different answer to the question above comes from authors

belonging to the **under-development and dependency schools**⁶. The answer is that production conditions at the centre and in the periphery differ in many ways and are not independent from each other: favourable conditions at the centre are closely related to unfavourable conditions in the periphery, and vice versa. Views among these authors differ but they have in common the emphasis on the role of historical factors and extra-economic sources of domination in the shaping of international trade relations⁷. Inequalities in trade are seen in connection to inequalities in development. These in turn are seen as a consequence of the way in which the capitalist system has expanded over time and has come into contact with other modes of production, central countries subordinating periphery ones to their own advantage. The whole international economy is seen as a system of domination organized to the advantage of the centre, which generates under-development in the periphery. Periphery countries do not gain proportionately less from international relations - they actually suffer from them. Development hence entails breaking away from the system of dependency through self-centred growth strategies. Thus, while the structuralists highlight the consequences of periphery countries being primary producers and Emmanuel highlights those of their being low-wage producers, under-development theorists see the matter in terms of these countries being at the losing end of a world system of domination.

More contemporary writers, like Marcel Mazoyer, have highlighted the effect of increasing globalization (see Box 4) on the unequal competition between modern agricultural producers and traditional peasant farmers, forced to compete on very unequal terms in the same global market.

Box 4: Globalization

Globalization has entered our current vocabulary and our conceptual toolbox in recent years, practically since the end of the cold war. The increase of commodity trade flows documented in Module I.1 Trends in World and Agricultural Trade and the progress on multilateral trade liberalization reached under GATT/WTO are only an aspect of it. Other equally important economic aspects are the international mobility of factors, particularly capital, and the internationalization of production and investment decisions. Thus, capital markets are fully integrated today into a closely connected net, enjoying a single system of hedging which allows them to react to leads and lags and relevant economic information at the world level. Transnational firms, big and small, make production and investment decisions also at the world level, both through their network of plants

scattered around the world and/or through a network of international contracts with third parties.

But globalization is not just an economic phenomenon; it has other important dimensions like the massive circulation of information at the world level due to the on-going revolution in communications technology, the growing inter-country standardization of regulatory aspects in economic, cultural, scientific, environmental and administrative matters, and the growing internationalization of life styles, human and aesthetic values, political agendas and social and cultural fads. .

The multidimensional nature of globalization has been captured in the **global village metaphor**, i.e. the view that globalization has made the world's economy and society akin to that of a single village extending worldwide. The global village metaphor is an effective one but should be taken with a grain of salt, for globalization trends coexist with phenomena setting apart countries, regions and social groups and marking wide gaps among them. Thus, nationalist, cultural and religious movements seem to have increased rather than waned with globalization, and the technology and income gap between North and South also seems to have increased. If anything, the global village is a rather unequal and multifarious place.

While, because of globalization, the prices of agricultural commodities are roughly similar in different countries, differences in labour productivities are formidable. Thus, argue Mazoyer and Roudart (1997, page 457), a European farmer well-endowed with land, inputs and equipment may alone produce 500 ton of cereal per year, while his counterpart in Sub-Saharan Africa working in a small plot of land with manual means may only be able to produce one ton per year. The point is not just the big difference in incomes ensuing from this gap in productivities, but also the fact that (i) continuous increases in labour productivity in modern farming puts a downward pressure on agricultural commodity prices, which is transmitted to peasant farmers throughout the world, and (ii) because of their low incomes, these farmers can hardly have access to modern technology.

A rules-based trading system is in the interests

of weaker economies

In response to these criticisms that trade is unfair where countries have different bargaining strengths or very different productivity and living standards, mainstream theorists reply that the lesson of comparative advantage theory is that initial conditions do not prevent countries from being able to exploit the gains from trade. However, where there are asymmetric power relationships, the less powerful countries have a strong interest in a rules-based trading system which limits the ability of economically-stronger countries to exploit their position at the expense of weaker economies. This is a powerful reason why it is in the interests of developing countries to participate in and shape a strong system of trading rules.

2.3 PROTECTION VS. FREE TRADE: ARGUMENTS AND DEBATE

Everybody would agree today that countries can hardly survive without trade, and that even if they could live in autarky they would suffer much from it. Hence, trade as such is not a policy issue. The important question is **how much trade**? Should policy makers stand for free trade in all cases or should they envisage providing domestic industries with some degree of protection? The relevant debate is whether there should be more, less or no protection. We discuss below the main arguments traditionally put forward for and against protection.

2.3.1 The case for protection

Protection can be advocated for purely economic reasons or on other grounds such as equity considerations, national security objectives, the defence of vulnerable groups, to avoid risks rated as unacceptable, and to defend certain interest groups because of political calculation. In the agricultural sector, protection can also be advocated on food security grounds.

Economic arguments

Economic arguments stress the role of industry learning...

Among the economic arguments for protection the most influential one is that of the **infant industry**. Protection is justified as a temporary measure while a nascent industry develops and comes to the stage where it will be ready to face international competition. Several reasons may exist to protect an industry during its infant phase. Those more frequently quoted are economies of scale, managerial and technological learning processes, start up costs (e.g. opening marketing channels, bringing in and adapting technology), and economies external to the firms but internal to the industry that

may take time and may need help to develop but once developed will allow the industry to stand on its own.

*...as well as
of market
failures...*

Protection is also advocated when markets relevant to the activity in question either do not exist or do not function well. Protecting the industry may allow it to operate under these conditions of **market failure**. Thus, for instance, lack or inadequate working of financial markets in a country may prevent an industry from raising the financial resources needed to modernize and withstand international competition. Protection may enable the industry to make the extra profits required to finance its expansion and technical improvement plans.

...and

externalities. There is a related but separate argument in favour of protecting industries which generate positive **externalities and spillover effects** for other groups. An argument of this nature is used to advocate continued protection to European farmers under the CAP (Common Agricultural Policy). It is claimed that agriculture is a multifunctional activity whose contribution is not just food production but also environmental protection, land stewardship, and preservation of the landscape and lifestyle of the countryside. By protecting European farmers from foreign competition, these beneficial side effects of agriculture, for which European consumers and citizens are believed to be willing to pay, would be preserved.

*...and terms
of trade
effects*

Another economic argument is that known as **optimum tariff theory**. In the case of importing and exporting countries sufficiently large to affect the world price of the particular commodity, a tariff on imports (or a tax on exports) may serve to improve the terms of trade in favour of the country. This is because by restricting imports the tariff will weaken world demand putting a downward pressure on the price of the imported commodity. Similarly, by restricting exports the export tax will weaken world supply putting an upward pressure on the price of the exported commodity. Of course, gains from protection obtained by a country in this way are at the expense of its trading partners.

A type of protection often applied in practice, known as **contingent protection**, seeks to counteract "unfair" trading practices, in particular the type of competition that results from **export subsidies** or from **dumping**. Protection is advocated because the price at which the commodity enters the country reflects distortionary practices on the exporter's side. Hence, it is not a price that the domestic industry should be expected to match.

Non-economic reasons

*Non-
economic*

*reasons
involve
redistribution
of income to
either more
vulnerable
or, often,
more
powerful
groups*

Social and political reasons for protection are often stronger than purely economic arguments. In essence, protection seeks to avoid the negative impact of import competition on the incomes of domestic factor owners. It is also a way of **favouring certain groups** considered meritorious of positive discrimination by the political decision-making process. This is the case with farmers in many countries, notably in Europe, Japan and the United States. Through the political process, for social and political reasons, societies in these countries have decided to give special economic treatment to their farming sectors, even at the cost of higher food prices to consumers and higher taxes (and also of reduced opportunities to other countries). This is a luxury that developing countries could hardly afford.

Sheer **political pressure** from powerful industrial or labour groups that stand to lose from free trade is also a common reason for protection.

Producing with the help of protection a more diversified collection of products than would be the case with free trade specialization may also bring wider social and political advantages such as improving **national defence**. This is an argument typically used for the protection of military and other so-called "strategic" industries.

Food security arguments

*Trade can
make a
contribution
to food
security...*

Protection can also be advocated for food security reasons. FAO defines the objective of food security as assuring to all human beings on a permanent basis the physical and economic access to the basic foods they need. This implies three different aspects: availability, stability and access. Thus, governments may try to ensure through protection that some minimum level of national production of basic foods is attained. Protection may also serve to shield consumers from severe fluctuations of external origin and to preserve the social and strategic advantage of food. However, the relationship between trade and food security is a complex one.

Trade can contribute to food security in a number of ways: by making up the difference between production and consumption needs; reducing supply variability; fostering economic growth; making more efficient use of world resources; and permitting production to take

place in those regions more suited to it. But reliance on trade may also bring some risks such as uncertainty of supplies, world market price instability, and increasing environmental stress if appropriate policies are not in place.

By contributing to growth of more efficient production, trade can be a source of income to a country. At the national level, additional foreign exchange from exports increases the capacity of the country to fill the eventual food gap. At the household level, the income generated by growth can improve access to food. This increase of income can benefit the poorer sections of population, provided they are involved in the production of exports or if there is an internal mechanism of redistribution or trickling down of the income generated. Some constraints may imply that small farmers are not able to benefit from opportunities for export production. Measures should then be taken to put them in a position to benefit from these opportunities. If not, their production could in fact be adversely affected by a possible increase of the price of land (due to increased opportunities of income from land arising from expanded trade).

*...but there
are also
risks*

In developing countries, export opportunities are usually better for non-food cash crops. Increased trade opportunities may therefore induce **substitution of food crops** by non-food cash crops. This can be favourable for the food security of producers if they can purchase food in local markets at fair prices. Food security could, however, be at risk if inefficiencies in the food marketing system result in high food prices. There are a number of examples where development of export cash crops has also resulted in an increase in food production because of the general improvement of input and service delivery to agriculture and the remaining effects on food crops of fertiliser used for cash crops. There are cases where the particular social and strategic value of food justifies some mechanism of protection. This is the case, for example, of **drought-prone countries** where food production is highly variable because of the frequent occurrence of droughts and where foreign exchange is mostly earned from agricultural exports. Export crop production is likely to follow the same pattern as food production, and hence foreign exchange earned from exports is likely to be insufficient in a "bad" year to import enough food.

The issue of **diversification of agriculture** is high in the agenda of many developing countries. One aspect of it is the diversification of agricultural exports. Many developing countries rely for their export earnings on one or two major commodities. Diversification aims at decreasing dependency on the fluctuations of the world market for these commodities and creating a base for more stable income flows.

Some countries are ready to forego income from trade in order to reduce the risk of **food dependency** on the world market. They are also ready to establish the mechanisms and pay the price to protect their food producers so as to encourage them to produce a certain

amount of food. This can be justified when there is uncertainty on supplies (poor transport infrastructure, uncertain access to port facilities or others). It must be noted, however, that food dependency may then be replaced by another type of dependency, such as the dependency on fertiliser imports, particularly in the case of small countries.

Food self-reliance is one approach to food security

Food dependency could also be induced by unfair trade practices like dumping or excessive export subsidies by trading partners which bring into the domestic market cheap food items against which local producers cannot compete. The issue of food security vs. food self-sufficiency is dealt with in Box 5. A concept that has gained increasing acceptance is that of **food self-reliance**. It implies maintaining a certain level of domestic production plus a capacity to import in order to meet the food needs of the population by exporting other products. This concept is fully explored in Module II.10 *Trade and Food Security: Options for Developing Countries*, where food security issues in the context of the Millennium Round of negotiations are discussed.

2.3.2 The case against protection

Many of the arguments against protection are also used in defence of trade in general, and have already been presented in Section 2.2. The main arguments for free trade (as opposed to simply trade) or, equivalently, the main arguments against protection are four: that protection promotes inefficiency, that it encourages rent-seeking behaviour, that it always implies a net welfare loss, and that there are usually more direct and efficient non-trade measures to achieve the desired objective.

Box 5: Food security vs. food self-sufficiency

The concept of food self-sufficiency is generally taken to mean the extent to which a country can satisfy its food needs from its own domestic production. It may seem that a country has more control over its food supply if it is not dependent on international markets, where food imports may come from countries which could be politically hostile.

The concepts of food self-sufficiency and food security differ on two fundamental points:

- food self-sufficiency looks at national production as the sole source of supply, while food security takes into account

commercial imports and food aid as possible sources of commodity supply;

- food self-sufficiency refers only to domestically produced food availability at the national level, food security brings in elements of stability of supply and access to food by the population.

In other words, food self-sufficiency is linked to an overall perspective on development, which emphasises the need for an auto-centric approach, whereas food security is consistent with a view of development which incorporates international specialisation and comparative advantage.

Those who believe that countries should develop international specialisation both within agriculture and between agriculture and other sectors of the economy argue that failure to take advantage of comparative advantage means that the country will not fully exploit its productive potential.

Those who believe that self-sufficiency is more beneficial argue that comparative advantage in export crops such as tea or rubber is not inherent in a country's physical resources, but a result of historical investment in certain industries often by colonising powers who wanted raw materials for their own industries or consumption. They argue that this has locked some countries into producing commodities which face declining terms of trade on inherently unstable international markets. Far from increasing their food security, these countries have declining and wildly fluctuating export earnings, thus making it difficult to plan imports and develop medium-term sectoral or national development plans.

A more significant argument for greater emphasis on food self-sufficiency can be made when a country's main food staple is not traded internationally in great amounts, resulting in a thin market. This is the case for white maize, and possibly for rice. When this occurs, an increase in demand from more than one major importer can push prices up and create difficulties for all importers.

Source: FAO. 1997. *Implications of Economic Policy for Food Security: A Training Manual*, p.19-21. Training Materials for Agricultural Planning No. 40. Rome.

Protection

promotes

inefficiency...The first argument stresses that by isolating domestic producers, at least in part, from the pressures of international competition, protection permits inefficient industries to perpetuate themselves at the expense of domestic consumers and of the soundness of the growth process. It also checks the dynamic process of entrepreneurial learning and innovation stimulated by exposure to international competition. By reducing competition and artificially raising profits, more firms may be attracted and be able to survive in the protected industries than would be economically justified, reducing the market share of the remaining firms and thus preventing the attainment of potential economies of scale.

...distracts effort into rent- seeking...

It is also argued that protectionist measures are usually granted by political decision-makers to production sectors on a rather ad hoc and frequently clientelistic way, and are often not connected to clearly identifiable and measurable losses from trade. This gives rise to situations where entrepreneurs and owners of productive factors in general focus their energies in lobbying decision-makers to obtain administrative concessions which would benefit them - referred to as **rent-seeking behaviour**. The proponents of free trade argue that since in most cases the political process makes the above almost unavoidable, countries are better advised to go for free trade without exceptions or, short of this, to go for low levels of tariff protection equally and transparently applied to all industries across the board.

...is costly to society...

Another argument against protection is that it makes society as a whole poorer in overall terms. The reason for this **welfare loss** is explained in greater detail in Module I.3 *Instruments of Protection and their Economic Impact*. Although producers benefit from protection, and the government benefits from the additional tariff revenue, their gains are more than counterbalanced by the higher prices consumers must pay for the protected commodity. If protection takes place through subsidies to producers or to inputs, then it will be the taxpayers that will lose out.

...and usually more effective alternatives exist

Of course, any cost to society must be weighed against the benefits which are sought from the protectionist policy. But it is usually the case that there are more direct and more efficient measures to address the market deficiencies which lie behind protectionist measures. For example, if it is desired to encourage infant industries, it would be better to do this through a targeted industrial subsidy than through trade protection which benefits all firms whether infant or not.

2.3.3 The prevalent consensus

*Desire for
freer trade
is now*

widespread...For these reasons, with differences of emphasis, the consensus nowadays among policy-makers around the world is that trade is advantageous and that the growth of international exchanges should be encouraged. The road to increased trade is through progressive reductions in the level of protection. This should be achieved by means of negotiations and reciprocal concessions. There are two methods, not mutually exclusive, to progress along this path. One is through **regional trade agreements**, which seek the reduction or elimination of trade barriers among a limited set of countries, normally (but not always) adjacent. The other is through **multilateral trade negotiations (MTN)**, like the ones which have taken place for several decades under GATT and are now taking place under WTO. These agreements are called multilateral because they **exclude preferential treatment** by one country to another country or set of countries, and are based on the application of the **most favoured nation (MFN) clause** to all countries entering the agreement ⁸.

*...but
politically
often
requires
concessions
from trading
partners*

In general, policy-makers do not make trade concessions without a *quid pro quo*. There is a history of international trade negotiations (and wars) of many centuries behind this. GATT/WTO negotiations are a modern system to discuss and agree on these *quid pro quo* in an organized and consistent manner. It is interesting that, while mainstream theoretical economists have traditionally focused on the gains from trade, implicitly or openly advocating the unilateral dismantling of trade barriers, policy-makers and practically-oriented policy economists have seen the matter in terms of **reciprocal concessions** ². This is probably due to a better understanding by policy-makers and practical economists of the imperfections and extra-economic features present in the operation of markets, as well as policy-makers' exposure to pressures from political constituencies who may suffer from international competition.

2.4 REGIONAL TRADING BLOCS

2.4.1 Different types of blocs and their effects

*Freer trade
can be
pursued in
either a
multilateral*

or regional context

Regional Trading Blocs (RTBs) can be broadly seen as reducing the economic significance of national political boundaries within a geographical area. There are various types of regional agreements that involve different commitments from participating countries. In **Free Trade Areas (FTA)**, member countries reduce or eliminate trade barriers among themselves but keep separate trade regimes with third countries. This allows members of FTAs to protect specific sectors against competition from non-members, if so they wish, but also creates many problems of custom administration because of the need to control **re-exports**. Thus, if countries A and B are members of a FTA, with zero tariffs on each other's imports, and A has a high tariff on computers while that of B is very low, traders will try to import computers into B and then re-export them to A. This problem is not present in **Customs Unions (CU)**, which are like FTAs except that participating countries agree on a common trade regime *vis-a-vis* third parties, i.e. on a common **external tariff** structure. CUs do not need to control re-exports but leave less room for individual members to protect selected industries, since they will have to negotiate with other members a high common external tariff for those industries. A more committed form of RTBs are **Economic Unions (EU)**. EUs are CUs where factors and not just commodities can circulate freely. Countries forming EUs may also harmonize aspects other than their economic policies such as financial and tax systems or labour regulations.

What advantages do countries derive from RTBs? This depends on many circumstances but, in general, advantages will be bigger the more **potentially complementary** the concerned national economies are. For example, two countries which have followed an import substitution strategy to build up a diversified industrial base but whose comparative advantage lies in different industries could gain significantly from a RTB. The reason is that there will be more room for specialization according to comparative advantage if the economies are complementary. Thus, trade integration in agricultural products between two countries will be more advantageous if one country specializes in tropical and the other in temperate products than if both are temperate or tropical producers.

When countries enter a RTB the reciprocal reduction or elimination of tariffs promotes the increase of trade flows among them over what they traded under protection. This effect is called **trade creation** and is a positive result of RTBs. The agreement will also promote the substitution of supplies from member countries for supplies from non-member countries, not because the member country is the cheapest possible source but because it enjoys a preferential tariff or no tariff at all. This effect is called trade diversion and may have a negative impact on efficiency since countries in the RTB may be importing goods from each other that are cheaper in countries outside the bloc.

2.4.2 The proliferation of regional trading blocs and agreements

**Regional
trade
arrangements
are
increasingly
popular**

In parallel with multilateral trade negotiations, RTBs have been initiated throughout the world since the 1950s among both developed and developing countries. To date, the most significant one has been the European Union (EU), which has had considerable impact on world agricultural markets and provides a benchmark for comparative analysis when assessing the coverage of other agreements.

Out of the total of 198 regional trade agreements notified to the WTO (or previously to the GATT), 119 are presently in force¹⁰. In recent years, policy-makers from developing countries have stated their commitment to regional trading agreements. Box 6 highlights some of the main existing agreements among developing countries.

Box 6: Main regional agreements among developing countries

Region	Organization	Member Countries
Sub-Saharan Africa	Central African Economic and Monetary Community (CEMAC in French)	Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon.
	Common Market for Eastern and Southern Africa (COMESA)	Angola, Burundi, Comores, Djibouti, Ethiopia, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Rwanda, Somalia, Sudan, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe.
	West African Economic and Monetary Union (WAEMU) (UEMOA in French)	Benin, Burkina Faso, Côte d'Ivoire, Guinea Bissau, Mali, Niger, Senegal, Togo.
	Economic Community of West African states (ECOWAS)	Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, The Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali,

		Mauritania, Niger, Nigeria, Senegal, Sierra Leone, Togo.
	Southern African Customs Union (SACU)	Botswana, Lesotho, Namibia, South Africa, Swaziland.
	Southern African Development Community (SADC)	Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia, Zimbabwe.
Asia	Asia Pacific Economic Co/operation (APEC)	Australia, Brunei, Canada, China, Hong Kong, Indonesia, Japan, Republic of Korea, Malaysia, New Zealand, Philippines, Singapore, Thailand, United States.
	Association of South-East Asian Nations (ASEAN)	Brunei, Burma, Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand, Vietnam.
	South Asian Association for Regional Co/operation (SAARC)	Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka.
Latin America	Andean Common Market (ANCOM)	Bolivia, Colombia, Ecuador, Peru, Venezuela.
	Caribbean Community (CARICOM)	Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St Kitts-Nevis, St Lucia, St Vincent, Trinidad-Tobago.
	Central American Common Market (CACM)	Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua.

	Latin American Integration Association (LAIA)	Argentina, Bolivia, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, Venezuela.
	Southern Common Market (MERCOSUR)	Argentina, Brazil, Paraguay, Uruguay.
Middle East & N. Africa	Cooperative Council for the Arab States of the Gulf (GCC)	Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates.
	Council of Arab Economic Unity (CAEU)	Egypt, Iraq, Jordan, Kuwait, Libya, Mauritania, Somalia, Sudan, Syria, United Arab Emirates, Yemen.
	Economic Co-operation Organization (ECO)	Iran, Pakistan, Turkey.

The political impetus to conclude regional trade agreements is, if anything, increasing. Several factors contribute to this: purely political considerations (as in the case of the EU); economies of scale, so that countries fear that their producers may be at a disadvantage *vis-a-vis* their larger scale competitors if they remain unaligned on a regional scale; the desire to use regional agreements to 'lock in' and even extend the multilateral liberalization achieved in the Uruguay Round (UR); and the drawn out UR negotiations and fear that there would be no final agreement which led countries to strengthen regional blocs in anticipation of trade polarization (WTO, 1998).

Agriculture can often be a problematic sector in RTBs because of the degree of domestic intervention in agricultural markets designed to achieve particular price and income goals. If trade barriers to agricultural products are removed as part of a RTB arrangement, but countries continue to pursue different price policies within the RTB, then major trade distortions will result. Allowing for transport and marketing costs, agricultural products will flow out of countries with low market prices and flow into the country with the highest market price in the RTB once trade barriers are removed within a regional integration arrangement. For this reason, agriculture is often left out of RTBs (e.g. the European Free Trade Association) or liberalized within the framework of specific tariff quotas (e.g. the Central European Free Trade Agreement). It is unclear if regional integration arrangements which exclude agriculture meet the GATT requirement for a waiver for RTBs that substantially all trade should be covered by the arrangement. The alternative is to develop a common agricultural

policy for the region as a whole, as the EU did. However, a common policy will result in a significant redistribution of income where members of a RTB have different levels of self-sufficiency for different products, as the EU has found. There is no easy solution to these problems as long as countries joining a RTB have different levels of agricultural protection.

2.5 RECENT PUBLIC OPINION CONCERNS ON INTERNATIONAL TRADE

Trade policy agenda now driven more by new concerns than by the traditional debates over terms of trade and unequal exchange

While structuralist and dependency views have somewhat receded in recent years (notwithstanding the falling prices of primary commodities and the debt crisis) the public debate on issues related to international trade has widened to include environmental, social and ethical concerns. This is a reflection of the uneasiness of many consumers about the acceptability of goods offered to them through trade either because of their inherent characteristics or because of the social relations under which they were produced. It is also related to the upsurge of "ethical movements", particularly in OECD countries. A large variety of non-governmental organizations feature prominently in the debate on these issues¹¹.

Some of the demands coming from this opinion sector are the following:

- labelling of organic produce;
- labelling of goods containing genetically-modified organisms;
- animal and plant health and human safety;
- social clauses in trade agreements to make access to markets conditional on exporting nations meeting previously agreed core minimum labour standards;
- promotion of human rights-sensitive codes of conduct by firms operating internationally;
- promotion of 'fair trade' networks (see Box 7).

Box 7: Fair trade

Fair trade (also called alternative trade) networks are being promoted by a growing number of organizations. It consists of direct links between producers from developing countries and consumers, mostly in industrialized countries.

Many of the small producers involved in direct trading links are women's co-operatives. Fair trade takes advantage of the willingness of a growing number of consumers to pay a different price and eventually to buy in different shops in order to ensure that what they buy has been produced under certain conditions and contributes to some social end. The criteria used to determine whether a trade relation is 'fair' tend to vary according to each alternative trade organization but some basic components may be summarized as follows:

- direct trading links with producers in developing countries;
- guaranteed minimum price to producers (country specific);
- price premium to producers;
- credit allowances or advance payments;
- goods have to be produced under certain "acceptable" conditions; and
- long term relationships.

Fair trade in food started in the early 1970s with cane sugar and coffee sold in specialized alternative shops. With the introduction in 1988 of fair trade labels, food products could also be sold through conventional marketing channels, thereby allowing a substantial expansion of the market for fair trade foods. These now include, *inter alia*, coffee, cocoa, tea, bananas and honey.

Advocates of these concerns propose that these issues be part of international trade negotiations and agreements, such as those taking place within the WTO framework. Others argue that trade negotiations should concentrate on economic issues, while human rights, health, social and cultural issues should be addressed in other fora.

Loss of indigenous skills and knowledge is another concern

Another concern over trade liberalization of food and agriculture products that has been expressed by academics, NGOs and farmers' organizations is the belief that this is causing peasant agriculture and its accumulated traditional knowledge to disappear. Similar concerns are echoed on the cultural impoverishment brought about by, for example, the disappearance of indigenous crafts and indigenous knowledge. Even though trade is said to generate knowledge and trust, it is argued that technologies are imposed on developing countries whose inhabitants learn to 'consume' new techniques but not to adapt

or generate new science and technology. Globalization trends have given new momentum to these concerns.

REFERENCES

- Amir, S.** 1973. *Le Développement Inégal*. Paris, Les Editions de Minuit.
- Baghwati, J.** 1988. *Protectionism*. Cambridge, MA, MIT Press.
- Corden, W.M.** 1974. *Trade Policy and Economic Welfare*. Oxford, Clarendon Press.
- Edwards, S.** 1995. *Crisis and Reform in Latin America: from Despair to Hope*. Oxford, Oxford University Press.
- Ellsworth, P.T.** 1964. *The International Economy*. Third Edition. New York, The Macmillan Company.
- Emmanuel, A.** 1972. *Unequal Exchange: a Study of the Imperialism of Trade*. London, Monthly Review Press.
- Johns, R.A.** 1985. *International Trade Theories and the Evolving International Economy*. London, Frances Printer Publishers.
- Krugman, P.R & Obstfeld, M.** 1997. *International Economics: Theory and Policy*. Reading, Massachusetts, Addison-Wesley.
- Lipsey, R.** 1960. *The Theory of Customs Unions: a General Survey*. Economic Journal. Vol. 70.
- Mazoyer, M. & Roudart, L.** 1997. *Histoire des Agricultures du Monde*. Paris, Éditions du Seuil.
- Prebisch, R.** 1959. *Commercial Policy in the Underdeveloped Countries*. *American Economic Review*. Papers and Proceedings, 49 No. 2.
- Prebisch, R.** 1950. *The Economic Development of Latin America and its Principal Problems*. New York, United Nations.
- Streeten, P.** 1987. *What Price Food? Agricultural Price Policies in Developing Countries*. Ithaca, New York, Cornell University Press.
- WTO.** 1998. *Annual Report*, 1998.

¹ Thus, if in our example one chip exchanges internationally for 90 kg of sugar, the gains from trade will go more to the United States than to Brazil. By selling one chip to Brazil, the United States obtains 90 kg of sugar, i.e. 40 kg more (80 percent more) than it would have obtained domestically. By selling 90 kg of sugar to the United States, Brazil obtains 1 chip, i.e. 0.1 chips more (11.1 percent more) than it would have obtained domestically.

² "More eager demanders" means in this context that United States consumers are prepared to give up more chips per ton of sugar than Brazilian consumers do.

³ This does not mean that the total gain to the country will fall since the volume of exports may rise in a way that more than compensates for the fall in the terms of trade.

⁴ The terms of trade are here defined as a price index of export commodities divided by a price index of import commodities of these countries.

⁵ The income elasticity of demand for a commodity indicates the proportion in which demand varies when income changes. If the increase in demand is proportionally bigger than the growth of income, the demand is said to be "elastic". In the opposite case it is said to be "inelastic" or "rigid".

⁶ We can include here, among others, authors like Samir Amin, Paul Baran, Theotonio Dos Santos, André Gunder Frank, Osvaldo Sunkel and Immanuel Wallerstein.

⁷ By extra-economic domination it is understood a form of dominion that arises not from a superior capacity to compete in more or less free and open markets, but from the use of coercion grounded on political, military or institutional superiority.

⁸ The application of the most favoured nation clause by country A to country B means that all imports of A from B will receive the best import treatment that A gives to any of its other trading partners.

⁹ This was not the case during the 1980s when many countries in the developing world dismantled their protection systems without any negotiation or reciprocal trade concession from their trading partners in the developed world. If these countries had decided to move to a more open economic system, why did they do it unilaterally not taking this opportunity to negotiate and seek some reciprocity from their trading partners? The answer probably is that negotiating conditions were very unfavourable to them at the time. They were in fact under great pressure to adjust their economies in view of their indebtedness, the reduction of foreign investment flows, the high international interest rates, and the strong fall in the prices of primary commodities that took place in the 1980s.

¹⁰ <http://www.wto.org/wto/develop/regional.htm> [21 February 2000].

¹¹ Organizations such as Human Rights Watch and the International Secretariat of Amnesty International are engaged in promoting the development of corporate human rights-sensitive codes of conduct. Non-traditional agricultural exports (NTAEs), especially floriculture, are highlighted as in need of special attention in codes of conduct and labour standards agreements because of the potentially severe health hazards involved. The Clean Clothes Campaign (CCC) in the Netherlands aims to improve labour standards and conditions of workers in the garments industry world-wide.

