Trade Liberalization: Welfare Distribution and Costs Discussion
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*Trade Liberalization: Welfare Distribution and Costs Discussion**

Ian Sheldon

The set of papers included in this session cover three interconnected topics: the impact of globalization on developing countries, the measurement of the costs and benefits of regional trade agreements (RTAs), and the global welfare effects of agricultural subsidies in developed countries. In light of the current stalemate in the Doha Round of World Trade Organization (WTO) negotiations, these three papers have something useful to contribute to the ongoing debate about multilateral trade liberalization.

Roe, Somwaru, and Diao address the fundamental issue of the impact of globalization on income levels and the rate of economic growth in the developing countries. This goes to the very heart of why the "Doha Development Agenda," with its focus on poverty-reduction through economic growth, is so critical to the future of the multilateral trading system, and possibly the WTO itself. As Charlton and Stiglitz note, "If the development focus of the Doha Round is to be a meaningful operating principle, then the overriding task of the round is to ensure that the liberalization agreements promote development in poor countries" (p. 293).

Roe, Somwaru, and Diao focus on the link between growth and openness of developing country markets, pointing to three important indicators: significant reduction in global poverty, increased share of developing countries in trade, and considerably smaller gains from globalization in some regions of the world, notably sub-Saharan Africa. Two key empirical questions arise from these indicators: Is there a relationship between trade liberalization, growth, and the alleviation of poverty, and why have some developing countries grown and others have not?

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Winters, McCulloch, and McKay in a survey of the literature on trade, growth, and poverty, recently conclude that both theory and empirical evidence support the view that trade liberalization will be poverty-alleviating in the long run and on average. However, they also caution that while trade liberalization may be a very cost-effective antipoverty policy, its impact will depend on the institutional and broader policy environment in which it is carried out. This relates to an important insight of Roe, Somwaru, and Diao concerning the "jointness" between institutions and economic integration, whereby the benefits of globalization are linked to institutional reforms such as enforcement of property rights that reduce barriers to trade.

However, this integration–institutional linkage may be less important if the gains to developing countries from trade liberalization, notably in the agricultural sector, are modest. Ackerman notes that analyses based on computable general equilibrium (CGE) models indicate considerably lower benefits of agricultural trade liberalization than were being forecast two to three years ago. Roe, Somwaru, and Diao note though, that if time is explicitly incorporated to allow for capital accumulation and increases in labor productivity, the dynamic gains from agricultural trade liberalization exceed the static gains. They conclude from this that institutional change in developing countries is contingent on economic opportunities, which in turn can be enhanced by agricultural trade liberalization.

Koo, Kennedy, and Skripnitchenko focus on the rapid proliferation of RTAs over the past ten years. On the basis of a standard gravity model, they analyze bilateral agricultural trade between countries for a cross-section of 132 RTAs using 1999 data. Koo, Kennedy, and Skripnitchenko's key result is that on average, RTAs have positive trade-creating effects in the agricultural sector, and they have positive effects on trade with nonmember countries. The general lack of evidence for agricultural trade diversion is somewhat surprising in light of Viner's caution that RTAs can actually reduce the welfare of member countries, and, therefore, additional empirical analysis would seem necessary to confirm the robustness of this finding.

Even if one believes that the trade-diverting effects of RTAs are not statistically important, it is important to note other criticisms leveled at the proliferation of RTAs. In particular, Bhagwati has argued that RTAs undermine a basic principle of the General Agreement on Tariffs and Trade (GATT) or WTO: nondiscriminatory, most-favored nation (MFN), trade liberalization. Consequently, even if RTAs are permitted under GATT Article XXIV, their proliferation, or what Bhagwati refers to as a "spaghetti bowl" of rules, will result in fragmentation of the global-trading system. Bagwell and Staiger provide more formal analysis of how RTAs may negatively impact the performance of the WTO in terms of its ability to deliver efficient multilateral outcomes. These broader concerns about RTAs become all the more pertinent given the recent history of stalemate in the Doha Round, suggesting that considerable caution should be taken in allowing their further proliferation.

Finally, in their paper, Schmitz, Schmitz, and Rossi address the connection between domestic farm policies in the developed countries and international trade. Specifically, they focus on whether domestic farm policies are truly decoupled from agricultural production. Decoupling farm policies was an important principle established in the Uruguay Round Agreement on Agriculture (URAA), and it has underpinned debate and analysis of successive U.S. Farm Bills, and reform of the Common Agricultural Policy (CAP) in the European Union (EU). From a developing country standpoint, a key part of Schmitz, Schmitz, and Rossi's analysis focuses on the effects of decoupling in the U.S. cotton sector. In particular, their simulation results show that losses in producer surplus to major African cotton exporters are considerably lower if a coupled target-price policy is replaced with a decoupled loan-rate. From this, Schmitz, Schmitz, and Rossi draw the interesting conclusion that a decoupling index is needed in order to evaluate the extent to which specific commodity programs are decoupled from production.

Schmitz, Schmitz, and Rossi's paper is important as it complements the recent theoretical and empirical literature analyzing the extent to which decoupled payments such as U.S. production flexibility contracts (PFCs) are truly decoupled. For example, Hennessy has shown with declining absolute risk aversion, decoupled payments are in fact coupled as they have both wealth and insurance effects. Chau and de Gorter show decoupled payments allow farmers to cover fixed-costs and therefore, delay their exit decisions. In terms of empirical analysis, Goodwin and Mishra find that decoupled payments have a modest effect on U.S. farm acreage.

In summary, these papers illustrate important issues in the ongoing debate on trade liberalization. There is empirical evidence of a connection between poverty-reduction and trade liberalization, and that the economic opportunities provided for by trade liberalization can impact institutional change in developing countries. This emphasizes the importance of achieving success in the Doha Round; otherwise, proliferation of RTAs may accelerate further, possibly fragmenting the global-trading system. Finally, real decoupling of farm policies is at the center of the debate on how to make developed country farm policies less trade-distorting.

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