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RSIS COMMENTARIES

Free Trade and Globalisation: Boon or Bane for the Emerging World?

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Globalisation, growth and equality are not always compatible. Income disparity amongst the peoples of the emerging world has become an issue of increasing concern, especially in the wake of the current global economic crisis.

A RECENT World Bank report shows that anti-dumping, safeguard and other trade barriers are currently in vogue. This is despite the fact that state leaders vowed at the London G20 summit not to do so in the wake of the global economic crisis. The report warns that the present year-to-date pace of new safeguard investigations is likely to make 2009 the second most prolific year since the WTO's 1995 inception. Not surprisingly, the surge in domestic protectionist pressures stems from the negative impacts of free trade on income disparity, as evidenced by worsening inequality in about two-thirds of countries between 1990 and 2005. Rising impoverishment of the poor, alongside the burgeoning largesse of the already rich, poses a major threat to global social harmony.

Free Trade Theory Revisited

The British economist, David Ricardo, propounded the seminal 19th century theory of comparative advantage. The overarching thrust of Ricardo's thesis is that free trade is essential to maximise global economic welfare. This is achieved by rewarding 'factors of production' according to their productivity, thus allowing nations and individuals to exploit respective 'comparative advantages'. Globalisation is a contemporary manifestation of free trade, promoting benefits that are ubiquitous, compelling, and incontrovertible. Globally, a stunning 135 million people escaped dire poverty between 1999 and 2004; this being more than the populations of Japan or Russia, with favourable impacts on more people, more quickly, than at any other time in history.

A Growth-Equity Trade-Off?

Although developing countries' income levels have been catching up with rich countries in this globalisation era, income disparity is widening within nations and between individuals. Within-country income distribution has become worse virtually everywhere. In China, for instance, urban-to-rural household per capita income in 2004 was 3.2 times, and the coastal-to-inland GDP per capita was 2.4 times; these differentials being amongst the highest in the world. Moreover, China is but a microcosm of increasing global income disparities. For instance, over the past decade, inequality has increased in 13 out of 18 Asian countries.

There are three explanations for free trade/globalisation failing to narrow country and global income inequalities.

Firstly, the assumption of 'perfect competition' is an ideal, rather than a reality. Protectionist trade barriers (via import quotas and tariffs) and the under-cutting of competitive forces (through subsidies) creates 'artificial' comparative advantages, destroying free trade benefits, and imposing high costs on local consumers and developing country exporters, alike. The second explanation for the growth-equity paradox is that the search for comparative advantage is based on factor endowment.

However, this development strategy can best be described as a 'race to the bottom' by poor economies. Emerging states seek to attract foreign direct investment (FDI) with promises of cheap labour and big competitive tax breaks, suppressing poverty wages, often below subsistence levels. As a consequence, the average wage of America's top-ten trading partners fell between the 1980s and 1990s, somewhat tarnishing globalisation’s lustre.

Finally, even if the international trade system runs exactly as theory suggests, the existing global financial architecture remains problematic. This is because it represents a division of labour favouring rich-country knowledge-intensive exporters, whilst emerging countries principally concentrate on exporting raw materials and low value-added goods. This 'static' comparative advantage obliges emerging countries to suffer from exclusive reliance on low value-added sectors, stunting their capacity to grow in a dynamic, transformational way.

Second-Best Policy Solutions

The danger of widening income disparities is that a tidal wave of rage against globalisation is building.

Yet, the greatest threat to globalisation does not come from the awakening of working people in developing countries, and the poor in advanced ones. Perversely, this threat comes from the rich and powerful states failing to address the perceived and real deficiencies and 'unfairness' of the present international trading and financial system. Bubbling to the surface are the twin evils of protectionism and economic nationalism. The policy response has been to more equitably share the gains from globalisation. Some truly innovative policies have been introduced, such as the 'Millennium Development Goals', social safety nets, and a variety of humanitarian assistance programmes.

For emerging countries, social policy is the 'flip-side' of an open economy. To avoid trading-off poverty reduction by chipping away at the benefits of globalisation, social policy should have a dual function: it must enhance social engagement in decision-making, but at the time same, give social direction to poverty reduction. Such a flexible, more socially responsible, approach to trade 'and' development enables anti-globalisation 'radicals' to obtain a legitimate voice in support of greater social enterprise.

Accommodating Civil Society

Moreover, organisations and charities aligned with the anti-globalisation movement, such as ATTAC

(*Association pour la taxation des transactions pour l'aide aux citoyens*), should be entitled to participate in global conferences. Such fora would provide excellent opportunities for pushing advocacy goals in civil society and democratising global policy-making, hence compensating losers from globalisation. Violent protest, made worse by non-involved anarchist groupings, would thus, hopefully, give way to peaceful and constructive dialogue.

Harmonious development demands the evolution of 'social enterprise'. This should embroider 'blended' value objectives into mission statements, focusing on sustainable profit but not at the cost of social and environmental imperatives, so critical for securing poverty reduction. Social enterprises have already proven their worth in Europe and North America. They mitigate pressure towards income inequality and purge the corrupt practices that so often taint government intervention processes.

In sum, then, free trade/globalisation is a crucial dynamic in poorer countries seeking development, but the excesses of capitalism need to be tempered by enhanced institutional and corporate responsibility.

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